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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1928.

Nos. 131, 132.

THE ST. LOUIS & O'FALLON RAILWAY COMPANY, and MANUFACTURERS' RY. CO.,

Appellants,

vs.

THE UNITED STATES OF AMERICA, and THE INTERSTATE COMMERCE COMMISSION,

Appellees.

THE UNITED STATES OF AMERICA, and THE INTERSTATE COMMERCE COMMISSION,

Appellants,

vs.

THE ST LOUIS & O'FALLON RAILWAY COMPANY, and MANUFACTURERS' RY. CO.,

Appellees.

BRIEF IN BEHALF OF THE NATIONAL CONFERENCE ON VALUATION OF AMERICAN RAILROADS, AS AMICUS CURIAE.

DONALD R. RICHBERG,
General Counsel, National Conference On Valuation of American Railroads, as Amicus Curiae.

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BRIEF IN BEHALF OF THE NATIONAL CONFERENCE ON VALUATION OF AMERICAN RAILROADS, AS AMICUS CURIAE.

STATEMENT.

There are two reasons for offering this brief.

1. The principal issue in this case is one of extraordinary public concern.

It is: How shall railroad property be valued for rate-making purposes, under the provisions of the Interstate Commerce Act.

2. The official representatives of the public interest seem constrained to adopt one theory of the law and to discard an alternative (but inconsistent) theory, which is supported

by equally impressive authority and which would sustain with equal force the action of the Interstate Commerce Commission, which is under attack.

It would be unfortunate in this momentous proceeding to have no argument whatsoever presented to the court upon principles which might be held decisive of the main question here propounded.

Alternative Theories of the Law

It appears to be the position of counsel for the carriers and for the government that the valuation of private property as the basis for public regulation is ultimately a **judicial** function; that such property has a value, independent of legislative action, which will be ascertained correctly if an administrative commission will follow the valuation rules laid down in the courts. The respective arguments follow: that the Interstate Commission has discovered (or failed to discover) this independent value of the carrier's property, by following (or failing to follow) the judicial rules, and that, therefore, its valuation should be sustained (or should be set aside). There is some show of authority to justify counsel on both sides in shaping the issues along the lines indicated.

On the other hand, there is equally good authority for urging that the valuation of private property as the basis for public regulation is ultimately a **legislative** function; that "property" has no absolute, inevitable "value," which exists independent of legislative action. There is good authority for urging that the value of property is determined, not only by the play of economic forces, but also by the laws which grant, regulate and prohibit that private dominion over things possessed, which is defined in the law as "property." In the light of these legal and economic principles, it becomes evident that a regulatory commission is not directed to ascertain what the value of

public utility property *is* (a question usually answered by the stock exchange); but that such a commission has the duty of determining what the value of the property *should be*.

It will be conceded that if the value of property devoted to public service were an independent fact, to be ascertained as one would find the *weight* of a bushel of wheat, then it might be necessary for the court now to decide whether such a fact had been correctly ascertained. But if it be conceded, also, that public regulation of public service enterprises necessarily increases and diminishes the values of properties thus dedicated to public use, then the court is *not* now called upon to decide whether the commission has correctly ascertained an independent fact. On the contrary, it is the contention of present counsel that the court is now called upon to decide this question: Did the Interstate Commerce Commission administer reasonably a public policy properly defined by Congress, when the Commission determined what value *should be given* to the present carrier property in order that the objects of public regulation might be accomplished?

In behalf of the public interests represented in the National Conference on Valuation, its counsel seeks this opportunity to demonstrate:

(a) That the Interstate Commerce Commission might have placed a lower valuation upon the O'Fallon property under the present law, or under more explicit legislative directions, enacted within constitutional limitations;

(b) That, in giving "due consideration to all the elements of value recognized by the law of the land for rate-making purposes," the Commission gave such generous weight to private interests in railroad property (in comparison with the weight given to public interests), that

these private interests have no reasonable ground for complaint, although the rate-paying public might well protest.

It should be evident that the present brief will neither duplicate nor merely extend the briefs filed for the United States and for the Interstate Commerce Commission, but that it will raise additional issues, deemed worthy of consideration because the arguments here presented are supported by many opinions of the Supreme Court and by the writings of legal and economic authorities of the highest rank.

It is submitted that, when a litigant seeks to have the legislative power of rate-making transferred to the courts, it is fitting for the proponents of legislative power to ask the court to consider primarily, not the wisdom, but the constitutional validity of the exercise of the judicial power which is invoked.

The opinions of the statutory three judge court, which sustain the order of the Commission, are reported in 22 F. (2nd) 980. (R., 125-140-148.)

SUMMARY OF ARGUMENT.

PART I.

THE INSEPARABLE PROBLEM OF RATE REGULATION AND VALUE REGULATION.

1. The valuation issue should not be isolated from the issue of rate regulation. If a public utility property cannot be valued in such a manner as to insure reasonable rates, then the conceded power of rate regulation is destroyed. The power to require reasonable rates comprehends the power to prevent unreasonable profits. To diminish profits, that might be made, is to diminish values, that might be obtained. Therefore, the process of rate regulation requires that the owners of a public utility property shall be deprived of a part of its potential value.

Argument, p. 14.

2. Between the maximum property valuation, which would be the basis for, and the result of the highest feasible rates, and the minimum property valuation which would be the basis for, and the result of, the lowest feasible rates, lies the legislative field of rate regulation. The valuation of a public utility property within these limits, as a basis for rate making, is an exercise of the legislative power of rate regulation within the range of legislative discretion—and is *not subject to judicial review.*

Argument, p. 20.

3. In order to justify judicial invasion of the field of legislative discretion the carriers are seeking to isolate the valuation issue from the issue of rate regulation. They are asking the courts to give utility properties a fixed value by compelling the use of a judicial formula of valuation. All property values are the joint product of economic and political forces. They depend upon rights conferred and protected by laws. If judicial action establishes a public utility property value which cannot be changed by legislative action, the legislative power of rate regulation is destroyed.

Argument, p. 23.

4. A careful analysis of the legal and economic concepts of "property" and "value" will clarify the problem.

Argument, p. 24.

(a) "Property is the dominion over things possessed—a "bundle of rights"—which is conferred by law.

Argument, p. 24.

(b) The "value" of property is the "power to command a price" for things possessed, which depends upon the power which the owner can exercise over his possessions—that is, upon the "property" which has been conferred upon him by law.

Argument, p. 33.

(c) The "property" of a public utility owner is not an absolute dominion, but one qualified by the public service obligations which he has assumed. Among these obligations is the duty to charge only "reasonable rates" for the use of the things which he has devoted to public service.

Argument, p. 37.

(d) Thus the "value" of his "property" is dependent upon the inescapable fact that his property (his "bundle of rights" conferred by law) includes only a limited "power to command a price". He can only command a price which the legislative power establishes as "reasonable". The power to establish "reasonable rates" necessarily includes the power to establish a "reasonable value" for the property used.

Argument, p. 39.

5. Therefore the legislative power of rate regulation must include the power of value regulation. If a law fixing a formula for the finding of value were written in the courts, the result would be the absolute destruction of a vital, far reaching legislative power, by the substitution of judicial authority for legislative authority in rate-making.

Argument, p. 39.

6. The Supreme Court has consistently maintained—

(a) that the rate making power is legislative;

(b) that there is no formula for finding the value of a public utility property.

Argument, p. 49.

PART II.

THE UNDERLYING ISSUE IN A VALUATION CASE.

7. The underlying issue in a valuation case, as in any rate-regulation case is: What is a fair price for the public service rendered?

Argument, p. 52.

8. The sole question to be presented for *judicial* review is: Has a "monopoly price" or a "confiscatory price" been established?

Argument, p. 64.

(a) A "monopoly price", as here defined, is one clearly exceeding any price obtainable by sellers under fair competitive conditions.

Argument, p. 65.

(b) A "confiscatory price", as here defined, is one clearly less than any price obtainable by buyers under fair competitive conditions.

Argument, p. 65.

PART III.

THE LEGISLATIVE STANDARDS FOR RATE REGULATION AND VALUE REGULATION.

9. In its exercise of the legislative power of rate-making Congress, in the Interstate Commerce Act, has authorized and directed the Interstate Commerce Commission—

Argument, p. 72.

(a) "To determine and prescribe what will be the just and reasonable" rates. (Sec. 15 (1))

(b) To "establish or adjust such rates" so as to provide a "fair return upon the aggregate value" of railway property. (Sec. 15a (2))

(c) To enforce a trusteeship imposed on every individual railroad in regard to net income exceeding the "fair return" upon the value of its individual property. (Sec. 15a (6))

(d) To determine the aggregate value through its individual valuations "ascertained" through "its investigation under Section 19a", giving "due consideration to all the elements of value recognized by the law of the land for rate-making purposes." (Sec. 15a (4).)

10. The legislative power thus provided no formula for fixing reasonable rates, but required its administrative agent to obtain a vast amount of information, to consider it and to report it, so that the basis for its conclusions might be known. A mere reading of the Interstate Commerce Act will demonstrate the impossibility of establishing "reasonable rates" by any formula or—by the same token—the impossibility of establishing the "value" of railway property by any formula. "A reasonable judgment having its basis in a proper consideration of all relevant facts"—is clearly all that is possible. Such a judgment has been exercised by the Commission.

Argument, p. 78.

PART IV.

THE DECISIVE ISSUE IN THE PRESENT CASE.

11. This "reasonable judgment" has been based on the principle that competitive prices should be high enough to support generously the credit of carriers whose securities represent prudent investment, so that the existing facilities may be maintained efficiently and further investments may be induced—and not unreasonably higher than the prices which would have resulted if the public had undertaken to furnish the service or to compete fairly with private enterprise.

Argument, p. 81.

(a) It would seem to be conclusive proof that rates have been fixed within the range of legislative discretion (between a monopoly price and a confiscatory price) if experience shows that the traffic continues to move in a reasonable volume and that additional investments continue to flow into the public service at reasonable rates of return.

Argument, p. 88.

(b) If rates or values established are attacked as "confiscatory", before an adequate experience has been had to demonstrate their effect, the court is called upon to decide (upon the record) that the owners of the property involved would not have undertaken to furnish this service, and would not now continue to furnish it, *voluntarily*, for the price which has been fixed.

Argument, p. 91.

12. This reasonable judgment has been exercised within a "range of legislative discretion" by a "tribunal appointed by law and informed by experience", and the Supreme Court has held that it does not sit "as a board of revision to substitute our judgment for that of the legislature, or of the Commission lawfully constituted by it, as to matters within the province of either."

Argument, p. 94.

13. But, in the present case, the carriers are seeking to avoid all discussion of a fair price for the service, by claiming that a property value exists independent of, and not to be affected by, their obligation to serve at a fair price.

Argument, p. 96.

14. The carriers contend that their property has a "true value which is the economic equivalent of the property", which value "must be determined" by giving "dominant consideration" to a theoretical cost of reproduction at "present prices".

Argument, p. 97.

15. No property has any independent, or "true", value —or any "economic equivalent"—which is measured by reproduction cost or any other cost. Earning power—not cost—is the measure of value; as the Supreme Court has always held. Costs only furnish evidence of what would be a "fair price" for the service to recompense the seller for his outlays. Reproduction costs are only evidence of the highest possible prices—evidence of monopoly prices.

Argument, p. 98.

16. Through the device of claiming that an absolute value inheres in their possessions, the carriers are in fact asking the court to establish a formula for fixing the value of their property; and thereby to establish a formula for fixing rates; and thereby to take away from the legislative branch of the government all substance of its constitutional power to fix rates, in order that only a fair price shall be charged for public services.

Argument, p. 107.

17. The carriers are asking the court (actually but not candidly) to establish a fiat value for all public utility properties at the amount of their theoretical reproduction cost —to substitute a judicial formula for legislative discretion—to transfer the legislative power of rate-making from the legislatures to the courts; and by judicial action to establish monopoly values for these properties as the basis for a constitutional right to charge monopoly prices.

Argument, p. 107.

18. The contentions of the carriers are based on (1) a false economic concept of "value", which the court is asked to adopt against the protests of all authoritative economists; and (2) a false juristic concept of "property", which the court is asked to adopt in repudiation of its own opinions and the concensus of legal commentators.

Argument, p. 107.

19. It is respectfully submitted that in the present case the carriers have not been deprived of any property right to charge a fair price for services rendered, or of any property value based on such a property right; that the rates, the earning power and the resultant value of the property of the carriers were established by the Interstate Commerce Commission, in a conservative exercise of the legislative power of rate regulation, well within the limits of the range of legislative discretion; all in conformity with the laws and the Constitution of the United States.

Argument, p. 114.

ARGUMENT.*

PART I.

THE INSEPARABLE PROBLEM OF RATE REGULATION AND VALUE REGULATION.

Point I.

The valuation issue should not be isolated from the issue of rate regulation. If a public utility property cannot be valued in such a manner as to insure reasonable rates, then the conceded power of rate regulation is destroyed. The power to require reasonable rates comprehends the power to prevent unreasonable profits. To diminish profits, that might be made, is to diminish values, that might be obtained. Therefore, the process of rate regulation requires that the owners of a public utility property shall be deprived of a part of its potential value.

The effort to isolate the valuation issue from the problem of public utility regulation can only serve to obscure the fundamental principles and issues which must provide the basis for determining the "value" of property devoted to public use.† The use of the word "value" seems unfortunate because of the implication that we are seeking to find an *economic fact*, when we are in truth seeking to compromise economic claims incapable of a purely mathematical fixation—the conflicting claims of seller and buyer concerning a fair price for a service. But the word "value" may

*Italics in quotations throughout this brief are ours unless otherwise indicated.

†Counsel for the railroad in their briefs in the lower court constantly demanded that the commission should be directed to find "the true value which is the economic equivalent of the property"—implying that the property had an absolute "value", which should not be affected by governmental regulation of its earning power. Thus the entire argument is shipped on an economic fallacy that will not float.

aid us to arrive at a just basis for rate regulation if we realize at the outset that all "values" are relative and that no "value" can ever be stated except after considering and answering the questions: Value, to whom? Value, for what? Value, under what conditions?

Value, to whom?

It has been long settled that in a condemnation case, it is the value to the *owner* (of property taken) and not the value to the *purchaser*, which must be determined; because "the question is, What has the owner lost? Not, What has the taker gained?" *Boston Chamber of Commerce* v. *Boston*, 217 U. S. 189, 195.

But it has been long settled also that in rate regulation it is the value to the *purchaser* (of services rendered) which must be determined, because the public is entitled to demand "that no more be exacted from it for use of a public highway than the services rendered by it (the company) are reasonably worth." *Smyth* v. *Ames*, 169 U. S. 466; Minnesota Rate Cases, 230 U. S. 352.

The impossibility of ascertaining a value without answering the question: Value, to whom? is made clear in the opinion delivered in *Boston Chamber of Commerce* v. *Boston*, *supra*, where it is held:

> "But the Constitution does not require a disregard of the state of the title. It does not require a parcel of land to be valued as an unencumbered whole. It merely requires that an owner of property taken should be paid for what is taken from him. It deals with *persons*, not with tracts of land" (p. 195).

Value, for what?

Earning power determines "value" for purposes of *condemnation* or *taxation*.

In valuing a bridge company's property in a *condemnation case* it was held that the earnings of this public utility

"must enter into and largely determine the matter of value".

Monongahela Nav. Co. v. *U. S.*, 148 U. S. 312, 319.

In a railroad *taxation* case, it was held that the value of property results from and varies with the profitableness of its use; and that "there is no pecuniary value outside of that which results from such use."

C. C. C. & St. L. Ry. Co. v. *Backus*, 154 U. S. 439, 495.

But in a *rate regulation* case, it was held that value was not—and could not be determined by actual earning power; because—"the value of the use, as measured by return, cannot be made the criterion when the return itself is in question."

Minnesota Rate Cases, 230 U. S. 352, 461.

Value, under what conditions?

Citations of authority are hardly needed to demonstrate that all property values depend upon conditions that affect earning power. Let us assume that the A-B Company has been earning 20 per cent on an investment of $1,000,000 and that its service is then duplicated by a competitor who cuts prices, thereby reducing the profits of the original enterprise to 5 per cent. The value of the A-B property would be affected by the changed conditions. Let us further assume that the A-B Company is a public utility. Is not the value of its property affected by its public service obligations? May not rates be required that are reasonably comparable to the charges for which the public could supply the same service and make a reasonable return on its investment? Must the public actually engaged in competition, in order to reduce unreasonable rates and to fix reasonable "values" for public utility properties? Or, is public regulation intended as a substitute for competi-

tion and based upon the theory that, when monopoly is tolerated, or authorized, competitive rates can be established by law? Can it be questioned that these conditions, under which public utility properties actually exist, must be given "due consideration" as "elements of value" in placing a "value" on these properties as a basis for public regulation?

Just because these questions—and so many of the "elements of value"—are blandly ignored in the arguments of public utility counsel (and apparently given no consideration in many judicial opinions), it seems desirable, even if not necessary, to begin this argument with a restatement of the principal purpose of public utility regulation, and with an insistence that the valuation issue should not be isolated from the major problem in which it arises.

> "The distinction, at least, between rate-making value and market value, even though it is sometimes recognized in judicial opinions, is far from adequately recognized. Yet it is *a distinction which underlies the whole theory of public utility regulation*, a theory which is based on the principle that certain enterprises, called public utilities, should not be allowed to charge whatever prices they might be able to charge if their power to coerce customers by means of the bargaining process were not to be limited. In view of the fact that the market values of public service enterprises are simply a capitalization of the expected earnings that follow the exercise of the property owner's coercive powers, they cannot properly be used as the basis of a rate control which is designed, not alone to observe, but to limit, these powers. It is the recognition of this fundamental difference between valuation as a measure and valuation as a modifier of market forces that has caused many writers on public regulation to put valuation for rate-making in a place by itself and to distinguish between this 'value' which cannot properly mean market value, and other judicial values, such as value for taxation, for damages, or for condemnation which, it is assumed, do properly mean market value."
>
> Bonbright—"The Problem of Judicial Valuation," Columbia Law Review, May, 1927.

The attempt to isolate the valuation of a public utility property for rate-making purposes from the problem of rate-regulation fails, not only because it leaves out of consideration a most influential "element of value," but also because it leaves the value to be determined in an economic vacuum. The valuator is asked to find the value of the property, not to its *actual* owner, but the value to *any* owner. No such value exists in fact. The valuator is asked to determine the value, not for *rate-making* purposes, but for *any* purpose. No such value exists in fact. The valuator is asked to determine the value, not under *stated* conditions, but under *any* conditions. No such value exists in fact.

Economists have long since agreed that there is no "true value" possessed by anything as an "abiding intrinsic worth". As expressed by a writer in the Columbia Law Review, Volume 27, page 624:

> "The 'value' of a thing is always its value for the particular purpose, and in the particular conflict, in hand at the time of valuation. Hence there is no necessary relation between any given value and cost, for cost was promoted and met by past interests which may or may not carry over into the present situation without change. The only 'true value' for the present will be the one which best resolves conflicting interests in terms of a stable adjustment. So far as the interests change, the 'true value' solution likewise requires change. One may recall here the fact that back in the period of falling prices the railroads were accused of urging that true value for purposes of rate making was synonymous with historical, rather than with reproduction cost."

Realizing poignantly that no economist will support the long, discredited notion that there is such a thing as one "true value", counsel for the carriers have been led to the assertion, in briefs in the lower court, that "for the last three centuries the economic theorists have been unable to agree among themselves upon a theory of value." But the

primary *meaning* of pecuniary value, universally accepted by economists, is the "power to command a price," or, in other words, an "exchange ratio"; and counsel for the carriers are seeking judicial support of the irrational proposition that things in themselves have a "true value", independent of the factors determining the owner's "power to command a price", or independent of the factors determining the ratio at which one commodity under designated conditions, will exchange for another.

It is impossible even to discuss a method of fixing a value in an economic vacuum. Therefore, counsel for the carriers, while claiming that they desire to have the court lay down the rules for finding the one "true value" (which is supposed to exist for anybody, for any purposes, under any conditions), are in reality seeking to have the court lay down the rules for finding a value which can exist only as the "value" of his property *to a monopolist*, used by him as the basis for fixing the highest possible prices for buyers who are compelled to buy! (See Point 15, *infra*.)

It may be conceded that if there were no legislative power of rate-regulation capable of reducing the power of the public utility owner to command a price, he might be able to realize substantially the "value" which is now claimed as the one "true value". The reason why he cannot realize such a "value", that is, the reason why he has no such "power to command a price", is because the legislative power of rate-regulation exists.

Therefore, from the beginning to the end of this argument, it is necessary to combat the effort of the carriers to isolate the valuation issue from the rate-regulation issue. It is necessary to continue to insist that **the value of public utility property is determined by and must be made responsive to the obligation to serve at reasonable rates.** In order to prevent this attempted isolation of the valuation issue, we must insist that no value can be stated for

any property, unless it be stated as a value to a particular owner, for particular purposes, under particular conditions. A value cannot be stated for a public utility property as a part of the process of rate-regulation, without stating it as: (1) a value to owners who are subject to the obligations of public service; (2) a value for rate-making purposes, which must be consistent with, and determined by the law that public utility rates must be reasonable; and, therefore, (3) a value arrived at by taking into consideration the inconsistent and conflicting private interests of sellers and buyers, which must be compromised in order to deal fairly with all private interests and to arrive at that balancing of private interests which is called, "the public interest".

Point 2.

Between the maximum property valuation which would be the basis for and the result of the highest feasible rates, and the minimum property valuation which would be the basis for and the result of the lowest feasible rates, lies the legislative field of rate-regulation. The valuation of a public utility property within this field, as a basis for rate-making, is an exercise of the legislative power of rate regulation, within the range of legislative discretion —and is not subject to judicial review.

There are certain economic limitations upon rate-regulation which cannot be disregarded. Rates might be fixed so high as to stop the use of the service, or so low as to stop the furnishing of the service. Legislative action to compel either result would not be the regulation of public service, but its destruction; and misguided efforts in this direction might well be restrained by the courts on the ground of the constitutional limitations upon legislative power.

But, the legislative power with which we are here concerned has been exerted only to compel the charging of

"reasonable rates". So the question presented is only one as to whether the Interstate Commerce Commission has acted in conformity with its delegated authority. In view of the conflicting interests of the sellers and buyers of any service, it is clear that there must be a considerable margin between those rates which would be most satisfactory to the sellers, producing the maximum value for their property, and rates which would be most satisfactory to the buyers, producing the cheapest efficient service for their use. There must be a considerable margin between rates which would be so unsatisfactory to sellers that they would cease to make further investments and seek to be relieved of public service obligations, and rates which would be so unsatisfactory to buyers that they would cease to use the service.

In and beyond the twilight zone between unreasonable rates and extortionate rates, a court in exercising judicial power may find it necessary to exercise its "independent judgment as to both law and facts;" and the same judicial review may be required in and beyond the twilight zone between unreasonably low rates and confiscatory rates. This, we understand to be the doctrine announced in the much discussed case entitled *Ohio Valley Water Company* v. *Ben Avon Borough*, 253 U. S. 287. Thus we find, at each end of the field of legislative power in rate regulation, a zone of uncertainty, wherein, in one case the independent judgment of the court upon the *facts* may cause it to set aside a commission order, although in another case, upon only slightly different facts, a similar order may be sustained.

The point we desire to make now is that there is an *assured* field of legislative discretion (which lies between the zones of uncertainty which may be called unreasonably high and unreasonably low rates) wherein legislative power is exercised through an administrative commission whose acts within this field are not subject to judicial review. Yet

there must be a considerable margin for difference of opinion as to what are "reasonable rates", so that within this same assured field of legislative discretion values differing in large amounts might be fixed for the same property by different commissions, or by the same commission under different circumstances. *Banton* v. *Belt Line Railway Co.*, 268 U. S. 413.

To give short, specific examples: (1) Different real estate appraisers of equal experience and impartialty will differ widely as to the values of the same real estate in a large city. (2) The same appraiser may place different values upon the same real estate before and after the passage of a zoning ordinance, or the enactment of some other legal restriction upon the uses of real estate. (3) Real estate peculiarly valuable for a railroad passenger terminal may lose some of that value through the growth of motor bus transportation and the consequent decline of local passenger business. This last example indicates the interdependence of rates and values. It may be impossible to charge former local passenger rates in competition with motor bus transporation or private automobile transportation. The decline of business, or its diminished profitableness, will reduce both the values of property peculiarly adapted to the business and the prices which can be charged and obtained for the service.

At this stage of the argument, it is only our purpose to emphasize the fact that there is a field of legislative power within which there *must be* a legislative discretion in the fixing of *values* for rate-making purposes. The effort of counsel for the carriers to establish a judicial rule of valuation, so that a "value" *must* be fixed at a specific amount, whereby "reasonable rates" *must* also be fixed at a specific amount, is in reality an effort to substitute a judicial rule for the "reasonable judgment" of legislative agents within the field of legislative discretion.

Point 3.

In order to justify judicial invasion of the field of legislative discretion the carriers are seeking to isolate the valuation issue from the issue of rate regulation. They are asking the courts to give utility properties a fixed value by compelling the use of a judicial formula of valuation. All property values are the joint product of economic and political forces. They depend upon rights conferred and protected by laws. If judicial action establishes a public utility property value which cannot be changed by legislative action, the legislative power of rate regulation is destroyed.

The judicial formula of valuation which the carriers are seeking to have established is that the present value of public utility property is always to be found by estimating the reproduction cost of the identical property at present prices.[1] The field of judgment left to the Commission is only a limited judgment in the weighing of evidence as to the amount of this reproduction cost, including the weighing of evidence as to what are the current or anticipated prices which should be applied. If such a formula were laid down, there would be an end of the legislative power of rate-regulation. If property devoted to public service (which has no inevitable value) must be *given* an absolute value, bearing a fixed relation to cost, then the charge for the use of such property becomes practically a fixed charge; and the determination of reasonable rates is no longer an exercise of legislative judgment, wherein the interests of the public may receive due consideration. Rate regulation is made an arbitrary process for determining what the public *must* pay for public services, regardless of what the service is

[1] "The true value, that is, the economic equivalent of the property, must be ascertained in a way to determine the worth as of the time of the controversy, that is, the then *present* value. This requires that effective and dominant consideration be given to the then *present* prices." Reply Brief for Carriers in the District Court, p. 13.

"reasonably worth" to the public. Thereby, in the perennial economic conflict between private sellers and public buyers, the inherent legislative power to protect public buyers is destroyed.

If property had an absolute value, an "abiding, intrinsic worth", there would be a justification for the establishment, by judicial rule, of a method whereby such a value *must* be ascertained. But since *no* property, whether used in private or public service, has any such absolute value, the effort to establish a judicial formula is simply an effort to have the courts *give* to public utility property this special "value" an act which, so far as it may be within the power of government, would be clearly an exercise of legislative power. The inevitable effect of such an exercise of judicial power would be to destroy the substance of the legislative power of rate regulation, which, to be effective, must include the power of value regulation.

Since the entire argument of counsel for the carriers depends upon the assertion that there is *one* "true value", *one* "economic equivalent of property", which can be ascertained by applying appropriate reproduction cost prices to an inventory of physical objects, it becomes necessary to return to fundamentals and to ask the court to consider the nature of the legal and economic concepts of "property" and "value".

Point 4.

A careful analysis of the legal and economic concepts of "property" and "value" will clarify the problem.

(a) Property is the dominion over things possessed —a "bundle of rights" conferred by law.

The greatest confusion is brought into any determination of the value of property rights by the common assumption that what is being valued is a physical object, when in fact things do not have pecuniary values *in themselves;* and

pecuniary values are found only in the rights of persons to use things, which rights are conferred and protected by law. These *rights* are the substance of an owner's "property".

> "There can be no conception of property aside from its control and use and upon its use depends its value. *Branson* v. *Bush*, 251 U. S. 182, 187."
>
> *Block* v. *Hirsh*, 256 U. S. 135, 165 (dissenting opinion).

> "In its proper use the term property applies only to the rights of the owner in the thing possessed."
>
> Amer.-Eng. Enc. of Law, Vol. 23, p. 261.
>
> 2 Austin, Jurisprudence, Secs. 1051, 1056.
>
> Macleod, Elements of Economics, Vol. I, pp. 141, 143.
>
> Raleigh, Outline of the Law of Property, p. 1.

> "The term property (although in common parlance frequently applied to a tract of land or a chattel) in its legal signification means only the rights of the owner in relation to it. It denotes a right * * * over a determinate thing. Property is the right of any person to possess, use, enjoy, and dispose of a thing."
>
> *Wynehamer* v. *People*, 13 N. Y. 378.
>
> 1 Blackstone, Com., 138.
>
> 2 Austin, Jurisprudence, 817; cited in *Eaton* v. *B. C. & M. R. R.*, *infra*.

> "All that makes this property of any value is the aggregation of rights or qualities which the law annexes as incident to the ownership of it."
>
> *Eaton* v. *B. C. & M. R. R.*, 51 N. H. 504.

> "Private property includes rights more or less numerous. Far from being a simple thing it is complex and has been called by law text-book writers a 'bundle of rights'."
>
> Ely, Property and Contract, p. 59.

One of the best statements of the nature of property is found in the classic opinion of Mr. Justice Doe, in *Thomp-*

son v. *Androscoggin Improvement Company*, 54 N. H. 545, at 551, 552, 554 (1874), which has been quoted with approval by numerous courts:

> "Property in land must be considered, for many purposes, not as an absolute, unrestricted dominion, but as an aggregation of qualified privileges, limitations which are prescribed by the equality of rights, and a co-relation of rights and obligations, necessary for the highest enjoyment of land, by the entire community of proprietors * * *.
>
> "The soil is often called property * * * but the proposition that the soil is property conveys a very imperfect idea of the numerous and variously limited rights comprised in landed estate. And it is sometimes necessary to remember that the name of property belongs to some of the essentially proprietary rights vested in the person called the owner of the soil. * * * Property is taken when any of those proprietary rights is taken of which property consists. *Arimond* v. *Green Bay, etc. Company*, 31 Wis. 316, 335."

Other forceful statements of the same doctrine, universally recognized by the courts, may be found by reference to the following selected authorities: *Block* v. *Hirsh*, 256 U. S. 135, 155, 156 (1920); *Transcontinental* v. *Emmerson*, 298 Ill. 394, 399 *et seq.* (1921); *Wynehamer* v. *People*, 13 N. Y. 378, 433 (1856). ("Whatever subverts his rights in regard to (a chattel) annihilates his property in it"); *Illinois Central R. R. Co.* v. *Commissioners*, 161 Ill. 247, 250, 251 (1896); *St. Louis* v. *Hill*, 116 Mo. 527 (1893); *Low* v. *Rees Printing Co.*, 41 Nebr. 127, 146 (1894); *Aiken* v. *Boston, etc. R. R. Co.*, 51 N. H. 504 (1872); *Springfield, etc. Company* v. *Allen*, 43 N. Y. 389 (1871); *Braceville Coal Co.* v. *People*, 147 Ill. 66, 71 (1893); 6 R. C. L., 261; 22 R. C. L., 37.

The Source of Property Rights

Starting, therefore, with a realistic concept of property as a bundle of rights, let us next consider briefly the source of these rights. One of our heritages from the "natural

rights" period of legal and political philosophy has been a tendency in some circles to attempt to classify the rights of property as natural and inalienable rights, not dependent upon civil government. This is discussed by Dean Pound "An Introduction to the Philosophy of Law". (Page 204.) Lawyers of romantic inclination have sometimes asserted that the right of property is of divine origin. [For example, Smith on Personal Property, page 58 (1908). And *Van Horn* v. *Dorrence*, 2 Dall. (U. S.) 304, 310 (1795).] But the more realistic jurists now present a uniform front on the subject, and agree that this "bundle of rights" called "property", is created by the state—conferred by law. One of the earliest statements of this fundamental truth is to be found in the opinion of the United States Supreme Court in *Calder* v. *Bull*, 3 Dall. (U. S.) 386, at 394 (1798), where Mr. Justice Chase wrote:

> "It seems to me, that the right of property, in its origin, could arise only from compact, express or implied, and I think it is the better opinion, that the right as well as the mode, or manner, of acquiring property, and of alienating or transferring, inheriting, or transmitting it, is conferred by society; it is regulated by civil institution, and is always subject to the rules prescribed by positive law. When I say that a right is vested in a citizen, I mean, that he has the power to do certain actions; or to possess certain things, according to the law of the land."

In *International News Service* v. *Associated Press*, 248 U. S. 215, Mr. Justice Holmes, concurring, wrote:

> "Property, a creation of law, does not arise from value although exchangeable as a matter of law. Many exchangeable values may be destroyed intentionally without compensation."

In *Pullen* v. *Comissioners*, 66 N. C. 361, at 363 (1872), the court stated:

> "Property itself * * * is the creature of positive law. The legislative power declares what objects in nature may be held as property."

In *Board of Commissioners* v. *Ryan*, 232 Pac. 834 (Okla. 1925), the court's syllabus reads:

> "Property in all its forms is a creature of law."

Numerous other statements to the same effect are available from early times to the most recent advance sheets.

See: *United States* v. *Steffens*, 100 U. S. 82, 93 (1879); *Kawananakoa* v. *Polybank*, 205 U. S. 349, 353 (1907); *Commonwealth* v. *Alger*, 7 Cush. (Mass.) 53, 84, 85 (1851). In Public Law Making, Ch. 7, Prof. F. J. Stimson a distinguished lawyer and teacher, states: "That property is but the creature of law all English jurists admit." Cooley, Constitutional Limitations, 7th Ed. p. 511; 2 Kent's Commentaries, 340.

Dean Pound has written that "ownership is a purely legal conception having its origin in and depending on the law", and this conception is that of all the jurists.

See: Pound, "An Introduction to the Philosophy of Law," p. 224; 2 Austin, Lectures on Jurisprudence, Sec. 731; Gray, Nature and Source of Law, Secs. 34-35-36-41-51-53; Holland on Jurisprudence, 11th Ed. 51 to 56; 87-88; Hobbes, Leviathan, Part 2, Ch. 18, p. 137-138 (1651); Ritchie, Natural Rights, p. 234; Jhering, Spirit of the Roman Law, Sec. 60; Locke, Treatise on Civil Government, Sec. 50; Huxley, Method and Results, p. 190.

In his book on the Theory of Legislation, Ch. VIII, p. 111, the great critic of the legal system, Jeremy Bentham puts the matter succinctly:

> "There is no such thing as natural property * * * It is entirely the work of law * * *. Property and law are born together and die together. Before laws were made there was no property; take away laws and property ceases."

Benjamin Franklin puts it similarly, Writings, Vol. X, p. 59 (Smyth's ed.):

> "Private property therefore is a Creature of Society, and is subject to the Calls of that Society, whenever its Necessities shall require it, even to its last farthing."

For a compact and authoritative exposition of "The Notion of Property" see "Property, its Duties and Rights," chapter on "The Historical Evolution of Property," by L. T. Hobhouse (1922).

It is not necessary to rely merely on *opinions* of courts, concerning the source of property rights. Their *decisions* reveal the same source. An interesting illustration in recent times of the creation by law, through the Legislature, of a new property right, a new stick added to the bundle of rights, is furnished by the so-called "right of privacy" cases. It was decided in *Roberson* v. *Rochester Folding Box Company*, 171 N. Y. 538 (1902), that the rights in a portrait of one who is the subject thereof, did not include the right to control the unauthorized use of copies. The Legislature of New York thereupon *created* such a property right. A certain young woman found that her portrait was being used for advertising purposes and brought suit under the statute for an injunction and for damages, an action predicated upon a property right which did not exist before the statute. This statute was upheld as constitutional by the United States Supreme Court in *Sperry & Hutchinson Company* v. *Rhodes*, 220 U. S. 502 (1911), Mr. Justice Holmes stating that the law had the effect of bringing this property right into existence.

It is well known that at common law there is no property right in a dead body[1]; and yet by statute it would be easily possible for the State to create such a property right, vesting it in a relative, for example. In fact, it was even the law within the experience of men still living that one human being could have property rights in another.[2] The source of such property rights was the law of the states.

It is not only the Legislatures which create legal rights; they may be created by the courts themselves. For example, there was a time not so far distant when the intangible known as "good-will" was not regarded as a property right.[3] Now it is the merest commonplace to state that "good-will" is one of the most valuable property rights

[1]Blackstone's Commentaries, 429; *Rex* v. *Lynn*, 2 T. R. 733 (1788); *Foster* v. *Foster*, 220 S. W. 215 (Tex. C. 1920).

[2]See such slave cases as *McCullom* v. *Smith*, 19 Tenn. 342 (1838), and *Harper* v. *Stonbrough*, 2 La. Ann. 377 (1847).

[3]See for example, the statement of Lord Eldon in *Cruttwell* v. *Lye*, 17 Ves. Jr. 335, at 346 (1810).

and in a few types of business it is almost the only property right of value. In *Esselstyn* v. *Holmes*, 42 Mont. 507, 516 (1910), the court described good-will as follows:

> "It is property capable of transfer and the owner is entitled to the same protection in the exclusive enjoyment of it as he is in that of his tangible possessions."

The source of this well known property right is the law, acting, in this instance, not through the Legislature, but through the courts. Another illustration of present-day importance is the creation by some courts of a new kind of property right described as the right of an employer to a "free flow of labor".[1]

It has been necessary to demonstrate with some care that property is a "bundle of rights" conferred by law—rights flowing from the exercise of sovereign power—and to demonstrate that property is not a natural, absolute right of fixed extent, in order to help destroy the fallacious doctrine that property can have a value independent of, and not subject to modification by the exercise of legislative power.

Even a fixed property right could not have the same *value* to all persons, for all purposes, and under all conditions. But since the right to be valued is itself conferred by law, it should be apparent that there cannot exist a right of property and a resultant value of property contrary to the will of the sovereign power which has created the property and given it its value.

> "There can be no legal right as against the authority that makes the law upon which the right depends." *Kawananakoa* v. *Polybank*, 205 U. S. 349.

Therefore, we find that since the law is the source of all property rights and resultant property values, the lawmakers can create or destroy, and increase or diminish the

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[1] For a discussion of this newly created right, see *Jersey City Printing Company* v. *Cassidy*, 63 N. J. Eq. 759 (1902); *Fletcher Company* v. *International Association of Machinists*, 55 Atl. 1077 (N. J. Eq., 1903), and *Hitchman Coal Company* v. *Mitchell*, 245 U. S. 229, at 252 (1917).

bundle of property rights, which owners can exercise; and thereby the law-makers likewise can change the values of such properties to their owners. Nor does the constitution of the United States prevent the legislative power from depriving men of property rights. The constitution merely prohibits a deprivation "without due process of law", in which is comprehended arbitrary action against individuals, or the practical destruction of all recognized rights of ownership under an excessive exertion of the so-called "police power". In a word, owners may not be deprived of property rights by the "arbitrary exercise of the powers of government unrestrained by the established principles of private rights and distributive justice". (*Bank of Columbia* v. *Okely*, 4 Wheat. (U. S.) 235, 244.) The definition of "due process of law" just quoted has been approved by the great constitutional lawyer, Judge Cooley in his comment that "we have met in no judicial decision a statement that embodies more tersely and accurately the correct view". (Cooley, Constitutional Limitations, 7th Edition (1903) page 505.) For a further discussion of the measure of this constitutional limitation we refer to the Conclusion Appendix A of this Brief, page 157.

Thus, while it is well-settled law that legislative power may not deprive persons of property without due process of law, or "withhold from the owners of private property just compensation for its use", which "would be a deprivation of property without due process of law" (*San Diego Land and Town Company* v. *National City*, 174 U. S. 739), it is equally clear and well-settled that the "bundle of rights", which constitute property, can be increased or diminished by legislative power and thereby property values can be likewise increased or diminished. (*Omnia Commercial Co.* v. *U. S.* 261 U. S. 502.)

One of the most valuable of the sticks in the bundle of property rights is the right of use. This right may be entirely destroyed by statutes, such as those concerning

liquor, gambling devices, obscene literature, adulterated foods, etc., whereby a pre-existing right of use may be taken away or rendered almost valueless. By the same token, the *regulation of use*, by the laws governing the use of property devoted to public service, must inevitably destroy some property rights and values, while, at the same time, perhaps giving other property rights and values. The imposition of an affirmative duty upon a railroad was described in an opinion of the Supreme Court as "taking its property in a very effective sense". Yet the regulation was upheld. (*L. & N. Railroad Company* v. *Central Stockyards Company*, 212 U. S. 132, 145.) Many further examples of the subtraction, addition and modification of property rights in the exercise of legislative power in public utility regulation, will be given under subsequent points. For the present we may well sum up the discussion of the nature of property and the effect of legislative action upon property rights and values by quoting from an opinion of this court:

> "The fact that tangible property is also visible tends to give rigidity to our conception of our rights in it that we do not attach to others less concretely clothed. But the notion that the former are exempt from legislative modification required from time to time in civilized life is contradicted not only by the doctrine of eminent domain, under which what is taken is paid for, but by that of the police power in its proper sense, under which property rights may be cut down and to that extent taken without pay."
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> *Block* v. *Hirsh*, 256 U. S. 135.

As an appendix to this brief, we are printing a mass of illustrative instances, in which legislators have diminished the bundle of rights called "property" by laws which have been upheld in the courts. The purpose of this extensive review of authorities is to demonstrate that an absolute *right* of property, and an absolute *value* of property, independent of, and not to be modified by, legislative action, cannot be established by a judicial formula of valuation, without the destruction of an essential legislative power

which always has been preserved and upheld by judicial authority and which must be preserved and upheld, in accordance with constitutional limitations. (Appendix A.)

(b) The "value" of property is the "power to command a price" for things possessed, which depends upon the power which the owner can exercise over his possessions—that is, upon the "property" which has been conferred upon him by law.

If there is an accurate understanding of the nature of property, it must follow inevitably that no property can be valued except after due consideration of the extent of that power over the use of the things possessed which the particular owner is permitted to exercise, for particular purposes, under particular conditions, by virtue of the particular rights conferred upon him by law.

There has been a wealth of discussion in legal and economic literature, concerning methods of *ascertaining* value, and concerning the nature of "value", as a *philosophical* concept. But there is no difficulty in stating what "pecuniary value" *is*. It is the "power to command a price". To state such a value is to state an exchange ratio —that is, the purchasing power of a commodity in terms of other commodities. This value depends upon the profits, present and anticipated, which the use of property may bring to the owner and, therefore, depends wholly upon the power of the owner to command a price for the use of his property. The economists and the courts are in agreement upon this conception of value:

> "The value of a commodity means in economics its power of commanding other commodities in exchange. It means the rate at which the commodity exchanges for others. * * * The value of a commodity thus conceived is its value in exchange. This is very different from its usefulness or utility or importance. In every-day discourse we use the word 'value', sometimes to indicate exchange value, sometimes to indicate utility or importance."
>
> Taussig, Vol. 1, page 115, Principles of Economics.

"In brief, exchange value is purchasing power; that is, a commodity has more or less value as it may be exchanged for more or less of other things. • • • In order to have value an article must be: (1) one which is transferable; (2) one for which we are willing to undergo some sacrifice; (3) one capable of satisfying some desire."

Laughlin, The Elements of Political Economy, pages 75-77.

"The value of property generally speaking is determined by its productiveness, the profits which its use brings to the owner."

Monongahela Case, 148 U. S. 328.

"But the value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use."

C. C. C. & S. L. Ry. Co. v. *Backus*, 154 U. S. 439, 445.

The foregoing opinions of the court are supported by more recent opinions. In *International Harvester Company* v. *Kentucky*, 234 U. S. 216, the court was required to construe a statute making it a crime to sell harvesters at a price in excess of their "real value". The plaintiff in error contended that the law provided no understandable rule of conduct, for the reason that no one could tell what the "real value" of a harvester would be at a particular time. The answer to this question by the highest court of Kentucky was that "real value" had been previously declared, and was declared, to be "the market value under fair competition and under normal market conditions". The Supreme Court of the United States reversed the Kentucky judgments on the basis of an opinion precisely in point in the present consideration of the contention of counsel for the carriers that their property has one "true value". Mr. Justice Holmes wrote the opinion of the

court (two justices dissenting) which, after stating the previously quoted definition of value by the Kentucky Court, reads in part as follows:

> "We have to consider whether, in application, this is more than an illusory form of words, when, nine years after it was incorporated, a combination invited by the law is required to guess at its peril what its product would have sold for if the combination had not existed and nothing else violently affecting values had occurred."

After remarking "how impossible it is to think away the principal facts of the case as it exists, and say what would have been the price in an imaginary world", the opinion continues:

> "Value is the effect in exchange of the relative social desire for compared objects expressed in terms of a common denominator.
>
> "It is a fact, and generally is more or less easy to ascertain. But what it would be with such increase of a never extinguished competition as it might be guessed would have existed had the combination not been made, with exclusion of the actual effect of other abnormal influences, and, it would seem, with exclusion also of any increased efficiency in the machines, but with inclusion of the effect of the combination so far as it was economically beneficial to itself and the community, is a problem that no human ingenuity could solve. The reason is not the general uncertainties of a jury trial, but that the elements necessary to determine the imaginary ideal are uncertain both in nature and degree of effect to the acutest commercial mind. The very community, the intensity of whose wish relatively to its other competing desires determines the price that it would give, has to be supposed differently organized and subject to other influences than those under which it acts. It is easy to put simple cases; but the one before us is at least as complex as we have supposed, and the law must be judged by it. In our opinion it cannot stand."

In *Standard Oil Company* v. *Southern Pacific Company*, 268 U. S. 146, the question presented to the court was the

value of a steamship which had been lost after a collision. Here clearly only a question of "market value" was presented, not a value for rate-making purposes, not the value which property *ought* to have, but the value which property actually had to an owner for purposes of sale under existing market conditions. The opinion of the court pointed out that where no market value could be established through contemporaneous sales of like property, the value might be taken as the sum "that in all probability would result from fair negotiations between an owner willing to sell and a purchaser willing to buy". The opinion held that "cost of reproduction as of the date of valuation constitutes evidence properly to be considered in the ascertainment of value", and then continued:

> "It is to be borne in mind that value is the thing to be found and that neither cost of reproduction new, nor that less depreciation is the measure or sole guide. The ascertainment of value is not controlled by artificial rules."

After quoting, with approval, the requirement for a "reasonable judgment" laid down in the *Minnesota Rate Cases, supra*, the opinion, by Mr. Justice Butler, quoted, with evident approval, from an English case, as follows:

> "But there is another matter infinitely more important than this (referring to original cost less depreciation)—known even to the most unlearned—the constant change which takes place in the market. It is the market price which the court looks to, and nothing else, as the value of the property. It is an old saying, 'The worth of a thing is the price it will bring'."

Thus reviewing the established economic and legal concept of value, we see that a pecuniary value, a value which can be stated in terms of money, depends wholly upon the owner's power to command a price. If the seller commands the market (through a practical monop-

oly), he can command the highest possible, or whatever is to him the most profitable, price. If the buyers command the market (where there is intense competition) they can command the lowest possible price, perhaps the least profitable to the seller. As a result, the values of property used must depend entirely upon market conditions and depend upon the location of power to control the prices for the use of property.

Long ago John Stuart Mill warned students of political economy that value and prices are determined by competition alone, and stated:

> "In so far only as they are thus determined can they be reduced to any assignable law."
>
> Political Economy, Volume III, Page 3.

Therefore, it becomes apparent that when the force of competition no longer operates as a regulator of values and prices, when prices are regulated by governmental action, there is *no economic* law which operates to fix "reasonable rates" or to establish "reasonable values" for property, unless the rate-making authority adopts, as a principle of regulation, some competitive principle, so as to exert *political* law in the direction of the economic law that *would* operate under such assumed conditions.

(c) The "property" of a public utility owner is not an absolute dominion, but one qualified by the public service obligations which he has assumed. Among these obligations is the duty to charge only "reasonable rates" for the use of the things which he has devoted to public service.

The limited dominion which a public utility owner can exercise over his possessions, the diminished number of sticks in his "bundle of rights," is exemplified in the mass of cases cited in Appendix A, to which we have previously referred. In addition to these cases attention should be called to the limitations specifically imposed on carrier property

rights by the Interstate Commerce Act, which are summarized in Appendix B.

To assert that a railroad corporation has the same unqualified dominion over a terminal station, yards, engines and cars—that a private corporation has over its factory would be to assert an obvious untruth. There would be precisely the same untruth in the assertion that the "property" of the railroad corporation and the manufacturing corporation is the *same* private property. Therefore it cannot be rationally asserted that these different properties have the same values, or even that their different values can be ascertained by assuming contrary to fact that their owners have the same rights of dominion over the things they possess. Obligations imposed by law are direct interferences with that exclusive control which is the very essence of "property" and the foundation of property "values." *International News Service* v. *Associated Press*, 248 U. S. 215.

This court has repeatedly recognized that property values are diminished by obligations, such as those listed in Appendices A and B and has sustained the validity of such diminutions. For example:

Railroads may be required to share terminals.

U. S. v. *Terminal Railroad Association*, 224 U. S. 383.

Railroads may be required to fence rights of way.

Missouri Pacific Railway v. *Humes*, 115 U. S. 512.

Railroads may be required to destroy weeds, to supply drainage for surface water, to sprinkle streets.

Chicago, etc., Railroad v. *Anderson*, 242 U. S. 283.

Chicago, etc., Railroad v. *Transberger*, 238 U. S. 67.

Pacific Gas & Electric Co. v. *Police Court*, 251 U. S. 22.

The obligation to charge only "reasonable rates" is an exceedingly radical diminution of property value—but it has been sustained for centuries.

(d) **Thus the "value" of his "property" is dependent upon the inescapable fact that his property (his "bundle of rights" conferred by law) includes only a limited "power to command a price." He can only command a price which the legislative power establishes as "reasonable." The power to establish "reasonable rates" necessarily includes the power to establish a "reasonable value" for the property used.**

The legislative power, in limiting the owner's "power to command a price" has not deprived the owner of property, but has merely determined, in an exercise of legislative authority, the extent of the dominion which the owners of public utility property shall be permitted to exercise over things possessed. The legislative power has determined that a public utility owner's "property" shall not include the power to command the prices most satisfactory to him; and therefore has determined that his property shall not have the "value" most satisfactory to him.

Point 5.

Therefore the legislative power of rate regulation must include the power of value regulation. If a law fixing a formula for the finding of value were written in the courts, the result would be the absolute destruction of a vital, far-reaching legislative power, by the substitution of judicial authority for legislative authority in rate making.

Ever since the opinion was handed down in *Smyth* v. *Ames*, there has been a persistent effort to obtain in the court the establishment of a judicial formula for finding the "fair value of the property", which the court held

should be the basis of fixing reasonable rates.[1] The court stated that in order to ascertain "that value" consideration should be given to numerous irreconcilable and inharmonious factors such as original cost and present cost of construction, amount and market value of bonds and stocks and probable earning capacity of the property and undefined "other matters". The subsequent controversies over valuation and rate regulation have been waged between interests seeking to have "dominant consideration" given to one particular factor. In other words, the effort has been to change a judicial opinion as to matters which should be taken into "consideration," in the exercise of a reasonable legislative judgment, to a judicial formula prescribing rules which would practically control the exercise of the legislative judgment.

In the meantime jurists and economists have criticised the *Smyth* v. *Ames* opinion because the court had apparently put the cart before the horse and held that "value" should be ascertained as the basis for earning power when it is a perfectly obvious and inescapable economic fact that "value" is the *result* of earning power. Yet if the opinion of the court had announced that reasonable rates should be fixed upon such a basis that *as a result* the owner would be able to realize a reasonable value in the use of his property,

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[1] "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of the public highway than the services rendered by it are reasonably worth." *Smyth* v. *Ames*, 169 U. S. 466, 546.

criticism could not have gone to the length of stating that the rule of *Smyth* v. *Ames* is "legally and economically unsound". Any objection would have been confined to a protest that the court had not prescribed any test for what it would regard as a "reasonable value".

An Interpretation of Smyth v. Ames.

It seems clear, however, upon a review of the preceding and succeeding cases, that the opinion in *Smyth* v. *Ames* was intended to mean that the *result* of reasonable rates should be to establish a reasonable value for the property. This is evidenced by the fact that the same justice who wrote the opinion in *Smyth* v. *Ames* shortly thereafter, in writing the opinion in *San Diego Land and Town Company* v. *National City*, 174 U. S. 739, stated that "the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the *fair value* of the property used for the public *or* the *fair value* of the service rendered". Later in the same opinion he stated explicitly that the company was entitled to a "fair return upon the *reasonable* value of the property at the time it is being used for the public".

In the thirty years since the opinion of *Smyth* v. *Ames* was written, the Supreme Court has steadfastly resisted every pressure to establish a judicial formula for valuation, whereby a Commission would be required to fix reasonable rates upon the basis of a *fiat value* of property, without compromising the conflicting interests of owner and user of property by exercising a legislative discretion to determine what are *reasonable* values for properties and reasonable prices for services. In the oft-quoted opinion in *Smyth* v. *Ames*, the court clearly intended to lay down the law that rates should not be determined solely according to certain formulated interests of the buyers or sellers of

service, but should be determined after consideration of the conflicting and varying factors of value upon which are based the conflicting and varying claims of parties in economic conflict.

The various "matters for consideration," which are stated, are to be "given such weight as may be just and right in each case," • • • and there may be "other matters to be regarded." The court clearly anticipates not merely the exercise of discretion in individual cases, but also the gradual formulation of principles based on experience in rate regulation, in the course of which there must be a constant balancing and compromising of "what the company (the seller) is entitled to ask" and "what the public (the buyer) is entitled to demand." If we regard the "rule" of *Smyth* v. *Ames* as a rule of evidence—not as a rule of decision—it becomes somewhat useful instead of wholly confusing. To describe the evidence which can be (or must be) considered by a jury requires a description of evidentiary facts that are in conflict. But to write a formula for decision requires a weighing of evidentiary facts and the elimination of conflict. The conflicting factors stated and not resolved in the opinion in *Smyth* v. *Ames* show that a rule of evidence—not a rule of decision—was intended.

Let us consider, for example, the factors of original cost and reproduction cost. In a time of declining prices in a competitive market, the seller will urge that he must be recompensed for cost of production; and the buyer will urge that he could produce the same goods or services today at a lower cost. The market price resulting will be more or less of a compromise of these claims, with a tendency for prices to be fixed at cost of production, because, as Alfred Marshall, dean of the English economists, writes, "Cost of reproduction exerts little direct influence on value, save when purchasers can conveniently wait for the production of new supplies." Principles of Economics (1907), Book 5, Chap

7, Sec. 6. On the other hand, suppose prices are rising. The seller's argument will be that he is entitled to sell the goods at what it would cost to produce them today, and the buyer's argument will be that the seller should be satisfied with a fair profit based on what it actually cost the seller to produce the goods.

It will be noted that today sellers of transportation service are seeking to have prices based upon reproduction cost, although thirty years ago they were seeking to have prices based on original cost. Their claims are not grounded upon faith in a particular economic theory or reverence for abiding principles of justice, but upon a recognition of immediate self-interest. It may be urged that the buyers of transportation service also have shifted ground in the last thirty years on the basis of immediate self-interest. But the establishment of a policy of government should not be based upon the immediate interests of either sellers or buyers. In writing the so-called rule of *Smyth* v. *Ames*, **the Supreme Court declined to hold that rates should be fixed upon dominant consideration of the interest of the buyers**. It declined to hold that in a time of falling prices, reproduction cost alone should be used to measure the rate base. The court did hold that original cost and reproduction cost and many other elements of value should be given consideration, so that a "fair value" might be established for property used for public service. Following the same logic, in recent years **the Supreme Court has repeatedly declined to hold that rates should be fixed upon dominant consideration of the interest of the sellers**. In other words, after a period of rising prices it is held—just as it was thirty years ago after a period of falling prices—that reproduction cost alone shall not be used to measure the rate base.

The Interstate Commerce Commission (and any rate-making public body) is required to take a long view of the

interests of sellers and buyers, in order to see, not merely how to satisfy the immediate interest of one or both groups, or how to work out a temporary compromise of the conflicting interests, but in order to see how to provide a reasonably permanent basis for compromising the conflicting interests. Standards of fairness that will persist are essential. For this reason the Commission has been compelled to give greater weight to the actual cost of production, shown by the money invested in the property than to the theoretical cost of duplicating the property. This is because cost of duplication could *only* be used as a rate base *in a time of rising prices* and could *not* be used *in a time of declining prices*. A railroad property is built up through contributions of capital, which must be represented by securities; and these securities must be maintained at approximately par, in order to sustain the credit absolutely required for the continuing expansion and improvement of facilities. If the property in which the capital has been invested is valued for rate-making purposes at not less than the amount of investment, it is at least *possible* to sustain the credit of the enterprise. On the other hand, if the property is valued at *less* than the amount actually invested and represented by outstanding securities, it will be *impossible* to sustain adequately the credit of the enterprise.

If reproduction cost, in a time of *rising* prices, is utilized as a rate base, not only will market values of securities representing actual investment be inflated, but surpluses will be earned, which may be used (and have been used) as the basis for additional stock issues. Also the expanded borrowing power will provide the basis for floating additional bonds. *But*, if a period of *declining* prices follows, a lower rate base, founded on reproduction cost, *cannot be established* by the regulatory commission without impairing the credit which the previous actions of the Commission have

built up, and which must be sustained in order to promote the most efficient public service.

Therefore, a regulatory commission *knows* that a reproduction cost factor, utilized in favor of the interests of the sellers today, simply cannot be utilized reciprocally in the interest of the buyers tomorrow. Thereby, it is evident that to give dominant weight to this factor is to adopt for regulation today a principle which cannot be applied to regulation tomorrow.

On the other hand, when the Commission considers the factor of the money investment necessary to build up the existing properties, the Commission *knows* that, if that money has been prudently expended and if outstanding securities represent the investment prudently made, then rates which provide a fair return upon that investment will sustain the credit of the company in a time of either rising prices, or falling prices. Merely by shifting the amount of the fair return to meet the current rates for money, the Commission will be able to sustain the credit of the enterprise. If prices fall and it is urged that the properties could be duplicated for less than the amount of money invested in them, public policy in favor of protecting investment and sustaining the credit of public service enterprises will prevent any actual duplication and will justify the charging of rates necessary to preserve the values of outstanding securities in order to give investors a reasonable return and to sustain credit so that the service may be improved and extended. [Certainly the judicial authority would tread firmer ground in protecting an actual market value of securities representing investment than in protecting a theoretical monopoly value which investors never have realized and never will realize without the aid of special legislation.]

On the other hand, in a time of rising prices, although a stable rate base might deny to the owners of securities a

temporary speculative profit, they would have little cause to complain of rates sufficient to give them an income equal to the current fair return upon similar investments, and a market value of one hundred cents on the dollar in the case of the sale of securities. Therefore, from the standpoint of seeking a principle of rate-regulation which can be applied permanently, regardless of shifting price levels, a regulatory commission is compelled to accept the fact that investment is a far more useful factor than reproduction cost, in stabilizing security values, in sustaining credit, and in doing equal justice to sellers and buyers at all times.

There is, of course, still left open to the sellers the "depreciated dollar" argument—a claim of little benefit to bondholders and, therefore, simply a claim that railroad stockholders should be given an economic security not possessed by any other class of investors in the nation.

The "Depreciated Dollar" Claim.

It seems unnecessary here to review the many arguments which have been presented against the validity of the "depreciated dollar" claim. It is dealt with in the report of the Commission and presumably will be dealt with in other briefs. It is, however, peculiarly pertinent to the present argument to point out that the depreciated dollar claim is a claim for *equitable consideration* and not the claim of a *legal right*. Millions of people buy life insurance policies to protect those near and dear to them, when they themselves, have gone. They pay premiums in dollars saved by personal sacrifice. If prices fall, their beneficiaries may receive more than was sacrificed. If prices rise, their beneficiaries may receive much less than was sacrificed. Trust funds are built up for private persons, donations are made to universities, hospitals, churches and charities. Investments for such purposes are made in bonds, bearing a fixed interest, payable ultimately in dollars. In other words, the noblest, most unselfish uses of money require reliance upon a return in money for money invested.

The great enterprises of the community rest upon borrowed money; national, state and municipal bonds and corporation bonds. The railways have been constructed and extended largely by borrowed money. The imperative, dominating need in the establishment of public policy, whether in regulation of public utilities or otherwise, to promote the security and comfort of the vast majority of the people of the nation, is to insure the stability of money returns from money investment.

To secure a stable purchasing power for money seems to be an appropriate ideal for private or political action. So far as such stablization can be reasonably accomplished, it will eliminate the depreciated dollar issue. But in the absence of effective stabilization, in the face of fluctuations in purchasing power whereby benefits ebb and flow between creditors and debtors, between buyers and sellers, there is no possible justification for the exercise of legislative power to save one group of investors from losses suffered by vastly larger and more important groups of security holders. Let it be clearly understood that the benefit to be bestowed upon the railroad stockholder cannot be obtained except by imposing additional sacrifice upon those who have not received the same special treatment. Beneficiaries of life insurance policies, the beneficiaries of trust funds, the holders of public and private bonds, would all be required, out of their income having a diminished purchasing power, to make up the loss of purchasing power suffered by holders of railway stock.

There is no *equity* in the depreciated dollar argument. It could have a sound basis only if it were necesary thus to increase the purchasing power of the stockholders dividends, in order to sustain the credit of the enterprise. That argument cannot be made because, as previously shown, a fair return upon investment fixed by current rates for

money will necessarily sustain the values of securities representing investment and sustain the credit of the enterprise.

Let us consider another factor mentioned in *Smyth* v. *Ames* and frequently derided as a basis for measuring "fair value". It is a factor which has a clear bearing upon fair rates. This factor is "probable earning capacity". If a large amount of traffic can be carried over the same rails, the property will produce a higher return from a lower margin of profit, that is, out of lower rates, than if a small amount of traffic is carried. Such an earning capacity gives greater value to one private property than is found in a similar property that may have cost as much, but has not the same earning capacity. But in fixing rates which must be the same rates for the same service, there must be an averaging of the earning capacities of the railroads affected, so that in the aggregate they will earn fair returns. Congress has so directed the Commission to fix rates in Section 15a of the Interstate Commerce Act. (Discussed later in this brief under Point 9.) But it is not here contended by any party that two lines of railroad, having the same original or reproduction cost, should be given different values as a basis for rate making because one has a greater earning capacity than the other. Yet, according to all standards for valuing property used in private business, the two properties would *have* different values, although their actual cost of construction or theoretical cost of reproduction might be the same.

It must be evident that the legislative power of rate regulation becomes in operation a power of value regulation. Therefore, in determining what rates ought to be charged, what rates are reasonable rates, the regulatory power must determine what values are reasonable values to be realized out of the use of property in public service. The moment a formula is laid down whereby a regulatory commission is

deprived of the power of compromising the conflicting, economic claims of buyers and sellers, and is required to adopt a formula for determining the value of the seller's property and thereby the value of the service rendered to the buyer, this vital and far reaching legislative power is destroyed by substituting for the legislative discretion a judicial discretion in determining how the conflicting economic interests shall be compromised.

Point 6.

The Supreme Court has consistently maintained:

(a) **That the rate making power is legislative.**

(b) **That there is no formula for finding the value of a public utility property.**

"The rate making power is a legislative power and necessarily implies a range of legislative discretion."

Minnesota Rate Cases, 230 U. S. 352, 432

"It is the province of the Legislature to make the law; and when the Legislature or the body acting under its authority establishes the rate to be thereafter charged by the carrier, it is the duty of the courts to enforce the rule of law so made unless the constitional limits of the rate making power have been transgressed. The rate making power necessarily implies a range of legislative discretion; and so long as the legislative action is within the proper sphere, the courts are not entitled to interpose and upon their own investigation of traffic conditions and transportation problems to substitute their judgment with respect to the reasonableness of the rates for that of the Legislature or of the railroad commission exercising its delegated power."

Louisville & Nashville Railroad Co. v. *Garrett*, 231 U. S. 298.

"Rate making is no function of the courts; their duty is to inquire concerning results, and uphold the guaranties which inhibit the taking of private prop-

erty for public use without just compensation under any guise."

Pacific Gas and Electric Co. v. *City and County of San Francisco*, 265 U. S. 403.

"The making of rates is a legislative, and not a judicial, function."

Terminal Railroad Assn. v. *U. S.*, 266 U. S. 17.

"What the company is entitled to demand in order that it may have just compensation is a fair return upon the reasonable value of the property at the time it is being used for the public. • • • The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."

Minnesota Rate Cases, 230 U. S. 352, 434.

Georgia Ry. and Power Co. v. *R. R. Commission*, 262 U. S. 625.

Standard Oil Co. v. *Southern Pacific Co.*, 268 U. S. 146.

In refusing to authorize the application of a formula, it was held in the *Georgia Power Case*, just cited, that "the refusal of the Commission and of the lower court to hold that for rate making purposes the physical properties of a utility must be valued at the replacement cost less depreciation, was clearly correct." Likewise, in the last case cited, it was held that "neither cost of reproduction new, or less depreciation, is the measure or sole guide" in finding "value".

The statements just quoted are peculiarly important because they are both followed by the quotation from the *Minnesota Rate Cases*, transcribed above. Furthermore, in the *Georgia Case*, the opinion of the court was accompanied by one dissenting opinion in which Mr. Justice McKenna asserted that the problem of valuation was, in his opinion, "direct and simple—with no baffling element in it." He continued: "It was only to find the reproduction

cost of the utility and this necessarily was constituted of the cost of its materials and the cost of their fabrication, less an estimate of depreciation from the new. These costs and depreciations representing its value at the moment of time it was being regulated and being used by the public, such moment being the time prescribed by the law for the determination of its value—determination of that upon which the rate for its use was to be based."

Thus it appears that in 1923 only *one* member of the Supreme Court (now deceased) took the position that there was a formula for finding the value of a public utility property for rate making purposes. This formula he stated; and it is precisely the same formula which counsel for the carriers are now seeking to have the court adopt. But the opinions of all the other members of the court have squarely asserted that valuation is not a matter of formula, but that there must be a "reasonable judgment having its basis in a proper consideration of all relevant facts". These relevant facts have been detailed in the familiar quotation from *Smyth* v. *Ames*, which is repeated in the *Minnesota Rate Cases, supra*, and in the *Georgia Power Case, supra*. It is perfectly clear that these "relevant facts" are those necessary for consideration in determining what are reasonable rates.

Thus, in substance, the court more than thirty years after the decision in *Smyth* v. *Ames* is still refusing to announce that public utility properties must be given a value to be determined by following a judicial rule—a value which would absolutely prevent the exercise of legislative discretion in rate making. But the court has repeatedly decided that rates and the resultant values of public utility properties must be determined by the exercise of a reasonable judgment, by the legislature or the commission lawfully constituted by it to exercise such judgment. *Minnesota Rate Cases, supra*, p. 433.

PART II.

THE UNDERLYING ISSUE IN A VALUATION CASE.

Point 7.

The underlying issue in a valuation case, as in any rate-regulation case, is: What is a fair price for the public service rendered?

The general underlying issue which is involved in this case is the ancient one of "the fair distribution of the rewards of industry." The particular underlying issue which must be decided is the equally ancient one of "the fair price"—the inevitable difference of opinion between the seller and the buyer of a commodity or a service.

Naturally a seller desires to charge the highest possible price (consistent with the largest aggregate profit) and a buyer desires to pay the lowest possible price (consistent with the largest aggregate service). When prices are determined by private bargaining, the seller and buyer attempt to justify their respective demands by ethical arguments—since man is a moral, reasoning animal. But in the end the dominance of the seller or the buyer is determined by economic power, by the control of the market, sometimes inadequately described as the law of supply and demand.

When the government takes upon itself the decision of this ancient and not altogether honorable controversy, between the seller and the buyer, the ethical arguments gain importance because modern government (or at least, let us say, government under the Constitution of the United States) rests on moral sanctions. Justice is to be established, domestic tranquility insured and the general welfare promoted.

A commission is created to ascertain and to enforce the charging of "just and reasonable" rates. The ethical standard is explicitly stated. The governmental power is called into action primarily for the benefit of the *users* of public utility service. But public power is not to be exerted solely in behalf of one class of citizens, and "just and reasonable" rates must be just and reasonable to the sellers as well as to the buyers. Thus we find provided also the requirement that there shall be a "fair" return to the sellers upon the "fair" value of the property used for public service. The ethical standard again is explicitly stated.

The following quotation contains a typical expression of the ethical concept which dominates judicial opinions upon rate regulation:

> "There must be a *fair* return upon the *reasonable* value of the property at the time it is being used for the public."
>
> *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 41.
>
> *Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Service Commission*, 262 U. S. 276.

It may be pointed out that we are here considering what may be called material ethics rather than spiritual ethics. It is not necessary to state a moral code based upon metaphysical conceptions of what is right and wrong, or good or bad. The ethics involved are those of enlightened self-interest, that is, *immediate* self-interest. If the buyer pays less than a fair price, sellers will not be induced to furnish, extend and improve the service he desires. If the seller charges more than a fair price buyers will not use the service to its utmost capacity; community prosperity will be retarded; buying power will be reduced.

The Ethical Standards of Regulation

It seems necessary to recall attention to the underlying issue in public utility rate regulation and to the ethical

standards which it is the duty of a regulating commission to enforce, because, in the arguments made in behalf of both sellers and buyers before courts and commissions, there is a constant confusion of appeals to ethical considerations *and* assertions of arbitrary rights resting upon supposed sovereign or economic law. There are claims that governmental power *must* be exerted to enforce the alleged *rights* of one party regardless of what is fair to the other party, or that economic power *must* be permitted free exercise regardless of what is fair to the party thus coerced. It is respectfully submitted that, if a just decision is to be rendered upon the issue now before this court, it is necessary at the outset for the court to found its consideration upon this proposition:

Every theory * * * every argument * * * every claim of legal right * * * every assertion of economic power * * * must be tested by the standard of what is fair to the other party.

A legal *right* to an excessive profit cannot be asserted to prevent the Interstate Commerce Commission from fulfilling its legal obligation to fix a "just and reasonable" rate. The protection of an economic *power* to charge an excessive selling price cannot be demanded from a Commission which is established for the very purpose of preventing such an abuse of economic power. The legal rights and economic powers which *may* be found in private property ***when devoted to private competitive enterprise*** cannot be asserted as legal rights and economic powers of private property when devoted to public service and subjected to public regulation for the very purpose of preventing the unjust exercise of *legal rights* and *economic powers*.

It is quite evident in reading the briefs heretofore submitted by counsel for the carriers in this proceeding (which follow the lines of arguments usually made by public utility lawyers to courts and commissions) that they are demand-

ing legal sanction for the *highest possible selling price* for the service which they furnish, although the very purpose of rate regulation by public authority is to *prevent* the charging of such a price.

Is the Highest Possible Price a Fair Price?

The carriers claim: (1) that they should be reimbursed in the rates for all operating costs including labor and materials necessary to maintain their properties in good operating condition; (2) that the rates should permit them to accumulate the necessary depreciation reserves to replace large units which become inoperative or obsolete; (3) that they should be reimbursed for all taxes paid; and (4) that, having been protected against any possible expenditures out of profits they should then receive, as net profits out of the use of private property, a fair return upon the present market values of all lands plus the reproduction cost at present prices of all their physical properties (without deducting any depreciation for expired service-life), including in that reproduction cost a return on many unrealizable, wholly theoretical "increases" in "value"; and a return on all imaginable intangibles such as "going concern value". Without pausing to criticise the absurd inflations of reproduction costs in the *methods* utilized by the carriers' imaginative estimators, it should be pointed out that on no conceivable theory could private property utilized in private competitive business earn *regularly* as *large* profits as those claimed for the public utility owners.

When current prices will cover operating costs, maintenance, taxes, depreciation and a "fair return" on all possible capital outlays (including the present cost of duplicating the identical plant and business) there will be no lack of competitors, where competition is possible. Such prices clearly exceed the *highest possible prices* which can be maintained in a competitive market, because competitive

prices will ordinarily produce much less, and cannot produce regularly so large a return on capital invested.

> "On account of this tendency of prices to equal the expense of production, the expense of producing a unit of a commodity is called its normal value." Ely, Economics, Book 2, p. 172 (1909).

> "A competitive standard is a cost standard. Where two or more producers are competing for the sale of the same article, and that article is capable of being reproduced in unlimited quantities, the price will tend to settle at the cost of production. This, however, is not the cost to the marginal or high cost producers, as is often erroneously imagined; it is the cost to the most efficient producer who in time increases the volume and reduces the price of his product to the extent that inefficient producers whose costs exceed the price are driven to the wall. The result is that the least cost in the long run becomes the standard of competitive cost, and the public gets the service upon the best terms possible. It is this cost-of-service principle, that regulation is striving to preserve.

> • • • • •

> "Regulation of public utilities in the United States has as its deepest purpose the perpetuation of ideals and standards attained in the field of natural competition. Any other presumption or conclusion would ignore the fundamental principles of American industrial development and place the purposes of law and economics at variance."

> Kirshman, The Principle of Competitive Cost in Public Utility Valuation, 35 Yale Law Journal 805.

Government regulation was established for the purpose of deciding the age old issue between the seller and the buyer upon the ethical standard of a price that is "fair" to *both*. Yet the carriers are demanding that government regulation, established primarily for the purpose of protecting the *buyer* against the oppressions of a government created monopoly, should now be utilized to insure so far as possible to the *seller* the *highest possible selling price* which he can exact from the buyer. The price sought is

higher than any which can be maintained in a competitive market—and therefore is a "monopoly price," as hereinafter defined. This oppressive demand is presented in the disguise of a "constitutional right".

"What the Traffic Will Bear."

There should be no misunderstanding of the true nature of the contentions of the carriers in this and similar proceedings. [It is submitted that the claim of one carrier in one proceeding can be properly tested by considering the aggregate effect of the consistent claims of all the carriers in similar proceedings.] They are seeking to obtain the *right* to charge "all the traffic will bear". This theory of rate making has been advanced persistently by the carriers and other public utilities ever since government regulation began.[1] The carriers generally admit (and admitted specifically in the recent western rate case, 113 I. C. C. 3), that *at the moment* the traffic will not bear the rates which they claim they are entitled, as a matter of law, to charge. The carriers are asserting a legal *right* to charge rates vastly in excess of what the traffic will bear. Thereby, they are laying the foundation for indefinite claims for increases in the event that the traffic will stand the strain.

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[1] "What is clear is that the value of railroad property is no basis for rate making. An arbitrarily established 5½% on value, when found, might well inflict gross injustice upon the shipper and put into the railroad treasuries a sum greater than the worth of the service rendered. There have been many suggestions and many legislative attempts to fix an arbitrary basis for rates by limiting earnings. Every single one of these has failed. The proper basis is just as clear today as it was thirty years ago. It is what the traffic will bear."

—Editorial, Wall Street Journal—August 2, 1926.

"It is highly improbable that it would ever be possible to get the railways to agree to seek an advance in rates sufficient to give a so-called fair return on a reproduction cost valuation. Their managers would know that if they did so they would encounter the united opposition of regulating commissions and shippers, and would arouse public sentiment more hostile than ever existed before. Railway officers fully realize that rates should be made not only in accordance with what the traffic will bear, but also in accordance with what public sentiment will stand."

82 Railway Age, 1147 (1927).

Is it not clear that the very fact that the railroads today cannot charge the rates which they *claim* they are *entitled* to charge (as a matter of legal *right* and as a matter of economic *right*) shows that *they do not possess the legal and economic rights which they claim?* They claim that the "value" of their properties is equal to their reproduction cost and therefore that reproduction cost estimates must control the fixing of the amount of value. They themselves insist that the word "value" is here used in its "ordinary meaning", which is "pecuniary value" or "market value", or in the terms of the economists, "value in exchange". Yet every such "value" is absolutely determined by *earning power* and the carriers themselves must freely admit that their properties do not have today the earning power necessary to support the values claimed.

Let us suppose that an individual had built a factory in 1914 which cost him $1,000,000 and that the most he had ever been able to make out of its operation was $40,000 a year. Suppose he employed an engineer to make a theoretical estimate of the "reproduction cost" of his factory, together with a large addition for the "going concern value" of his 4 per cent business, and thereby he arrived at a reproduction cost new (without depreciation) of $2,500,000. Would a bank lend him $1,000,000 at 5 per cent on that security, knowing that the present net earnings would fall short of paying the interest on the loan by $10,000? Would any impartial judge fix the "value" of that property at $2,500,000?

It will be the purpose of present counsel subsequently to demonstrate that reproduction cost cannot be accepted as the *measure* of "value" under any definition of the word "value". But for the moment it is desired merely to point out that when counsel for the carriers admit that the traffic will not produce the earning power necessary to substantiate the pecuniary or market "value" which they claim as

the "value" of their properties, they reveal in a white light the fictitious nature of the entire "value" claim. They themselves *admit* that in fixing "just and reasonable" rates *the Commission is not required to provide a fair return upon the "value" which they claim.* Thereby, they admit that such a value does not *exist*, either as a rate base or a "market value" or a "fair value" or any other kind of a "value".

The Cost of Service—as a Measure of the Fair Price

If the establishment of a "fair value" for rate-making purposes is recognized as one of the *objectives* of the rate fixing process, instead of being regarded as a prerequisite *base*, the question remains: How can a fair price be fixed before the "fair value" of property used is fixed? The method is clearly indicated as soon as one realizes that, where there is no legislative rate making, prices are always fixed without a prior determination of value; and the same factors that determine unregulated prices can be utilized to fix regulated prices. These factors are (1) Cost; (2) Profit; (3) Bargaining power.

Cost.

Whether a seller furnishes goods or service his first consideration in fixing a price is to get back his out-of-pocket cost. Without argument it will be accepted that the seller *ought* to get back this cost—although under stress of competition the seller is not always able to do this. This cost will include labor costs, material costs and capital costs—actually paid out.

Profit.

In addition to getting back his out-of-pocket costs, the seller will desire to obtain a "profit," within which term we will include compensation for his *own* services and com-

pensation for the use of his *own* property. Despite much discussion and many efforts to establish standards for fixing a "reasonable compensation" for personal services or for the use of property, we are left, in a competitive economic system, with only one clear standard, which is: "market value" in a "fair market"—meaning a market in which there is an even balance of bargaining power between sellers and buyers. Since supplies and demands cannot remain in perfect balance "market values" are constantly changing and a "fair market" is only an ideal. But "competitive prices" measure (within a considerable range of variance) that margin of profit to the individual which is commonly accepted as "reasonable" compensation for the use of his services or his property.

Bargaining Power.

Since, therefore, we are forced to find in *competition* the sole basis for determining what is a "fair price," it is clear that an advantage of bargaining power will drive prices either up toward "monopoly prices," obtainable where sellers dominate the market, or down toward "confiscatory prices," obtainable where buyers dominate the market. Before attempting the difficult task of defining these prices, in a manner consistent with judicial opinions, let us point out that there are two kinds of "cost" that both play a powerful part in determining the competitive price for a service—the actual original cost of producing the service and the present theoretical cost of duplicating the service. If the buyers have the advantage of bargaining power, they will drive prices down toward actual cost, toward the prices at which supplies will diminish and prices will rise. If the sellers have the advantage, they will drive prices up toward present cost of duplication, toward the prices at which supplies will increase and prices will fall.

Thus we see that, although *one* set of "costs" will provide no safe measure of "value," consideration of *both* sets of "costs" will help us to locate the field of "competitive prices" and thereby to estimate what a "competitive value" would be. Thus reports of original *and* reproduction costs will furnish factors useful for consideration in fixing a "fair price." With these costs of public service before us, it becomes necessary to assume the existence of a continuing competition in the furnishing of this service. This is merely the assumption that there has been at all times a balance of bargaining power between the sellers and users of public service (which would prevent the sellers from charging more than "fair prices"). This assumption is based on the public policy actually adopted, whereby, instead of engaging in active competition with privately owned utilities, in order to obtain competitive rates, the legislative power has been exercised to give the public the *same protection* through rate-regulation. This is the only practical method (so far discovered) of encouraging private interests to engage in public service and of protecting public interests at the same time.

If the legislative power should be denied the right to fix rates so as to compel public utility owners to charge no more than "fair competitive prices" there would be a clear duty imposed upon the legislative department to exercise its undoubted power to engage in active competition.

> "The power to construct or to authorize individuals or corporations to construct national highways and bridges from state to state is essential to the complete control and regulation of interstate commerce."
>
> *California* v. *Central P. R. Co.*, 127 U. S. 39. Approved in *Dayton Goose Creek Railroad Company* v. *United States*, 263 U. S. 456, 479.

No monopoly is so entrenched in property rights as to make a competitive service impossible in this rapidly changing world. If the railroads of the United States could not

be taken for public use without paying a compensation equal to their "monopoly value," based on the theoretical cost of duplicating the identical properties—other means of competition would not be lacking.

Already surfaced highways link together more cities and towns than are served by the steam railroads. The commercial use of airplanes is in its infancy and the airways are as yet not subject to private property rights. Engineers have pointed out long ago the appalling waste of energy in hauling a train weighing ten times the weight of its passengers, in order to transport these persons by rail; and have called attention to the fact that motor buses haul practically their own weight of passengers.

The legislative power is still adequate to *compel* common carriers to charge fair competitive rates through creating actual competition in service, *without duplicating the identical properties* now used. But it is hardly to be assumed that such means are necessary. It would require an extraordinary change in the legal principles that have been developed and maintained for centuries, to bring a ruling that the legislative power of rate regulation is not sufficient to insure the furnishing of public service at the same "reasonable rates" that would be obtainable through the bargaining power of actual, fair competition.

Nor is it to be expected that the exercise of legislative judgment in fixing rates in the rather large field of competitive prices will be subjected to judicial revision; because, in the long run, the final decision must rest in the legislative department. Having determined the prices at which a fair competition can be maintained, the legislative power, in protection of the public interest, must finally decide to enforce the charging of such "fair prices," either by the governmental power of rate regulation or by the governmental power of competition. Such a determination of public policy is a purely *legislative* act.

Legislative Power to Determine Public Policy.

"Where the law is * * * calculated to effect any of the objects entrusted to the Government, to undertake here to inquire into the degree of its necessity would be to pass the line which circumscribes the judicial department, and to tread on legislative ground."

Marshall, C. J., in *McCulloch* v. *Maryland*, 4 Wheat. (U. S.) 316, 423.

"Nor was the holding of the court final upon the point of public policy. The legislature, provided it acts within its constitutional authority, is the arbiter of the public policy of the state."

C. B. & Q. Railroad Co. v. *McGuire*, 219 U. S. 549, 565.

To the same effect is

Interstate Commerce Commission v. *I. C. R. R.*, 215 U. S. 452, 470.

"The public policy of a State is to be found embodied in its constitution, its statutes, and, when these are silent on the subject, in the decisions of its courts. The public policy of the State, when not fixed by the constitution is not unalterable but varies upon any given question with changing legislation thereon, and any action which, in the absence of legislation thereon, by the decisions of the courts has been held contrary to the public policy of the State, is no longer contrary to such public policy when such action is expressly authorized by legislative enactment."

The People v. *City of Chicago*, 321 Ill. 466-475.

Does it not follow that legislative *power* exists to enforce legislative *policy?* Therefore it should be clear that the field of legislative power in rate making extends between monopoly prices and confiscatory prices, covering a wide range of competitive prices, wherein the exercise of a "reasonable judgment" is not subject to judicial review.

Point 8.

The sole question to be presented for judicial review is: Has a "monopoly price" or a "confiscatory price" been established?

The Interstate Commerce Commission has been authorized only to establish "just and reasonable" rates. Therefore, such unreasonable rates as might be charged (1) in the absence of competition, or (2) in the presence of destructive competition, could not be established within the delegated power. Thus only *fair* competitive prices are comprehended within the range of legislative discretion; and for convenience and clarity of discussion we may be permitted to define the field of discretion in rate-regulation as follows:

There is a central line where the bargaining powers of sellers and buyers are evenly balanced, where competitive conditions are ideal. From this line the field extends to right and left into domains where sellers and buyers respectively have an increasing advantage in bargaining power, until we reach a zone of uncertainty at each end of the assured field of regulatory power. In these zones of uncertainty the judicial power may, in the exercise of its "independent judgment," determine: (1) that too great "power to command a price" has been given to the sellers and "monopoly prices" have been fixed; or (2) that too great "power to command a price" has been given to the buyers and "confiscatory prices" have been fixed. Under the standard of "reasonable rates" the owners of property, used in public service, are entitled to realize "reasonable values" for such property. It follows that unfair competitive prices will confer either a "monopoly value" or a "confiscatory value" upon the property used. Therefore, we are justified in defining the field of judicial review as

comprehending those "monopoly prices" or "confiscatory prices" that are *clearly* more or less than "fair competitive prices."

(a) **A "monopoly price," as here defined, is one clearly exceeding any price obtainable by sellers under fair competitive conditions.**

(b) **A "confiscatory price" as here defined, is one clearly less than any price obtainable by buyers under fair competitive conditions.**

In order that the foregoing definitions may be serviceable in the present discussion, it is necessary to emphasize that the standard of "fair" competitive conditions must be also defined and the word "clearly" must be liberally construed —or there will be an unwarranted contraction of the field of legislative discretion.

> "It is fundamental that the judicial power to declare legislative action invalid upon constitutional grounds is to be exercised only in *clear* cases. The constitutional invalidity must be manifest and if it rests upon disputed questions of fact, the invalidating facts must be proved."
>
> *Minnesota Rate Cases*, 230 U. S. 352, 452.

We are now faced with the necessity of describing with some accuracy the field of fair competitive conditions so that lines may be drawn between fair (competitive) prices and either excessive (monopoly) prices or insufficient (confiscatory) prices. A clear understanding of (1) what *are* competitive conditions, (2) when they are "fair," and (3) what are fair competitive prices, is indispensable to a rational criticism of rate-regulation. Under other social, political and economic systems there might be more easily defined standards of "fair prices" and "fair values" (although we have no assurance that they would be *better* standards). But we must face the fact that under actual present conditions we have *no* standards of "fair prices" or "fair values" *except* the prices and values which

actually prevail in a "fair" market—which is a free market where neither seller or buyers have any special advantage in bargaining power.

The fact that actual "market value" is the only *real* value which can be ascertained as an economic *fact* at a particular time, has been recognized and clearly stated by the economic and legal authorities (including the Supreme Court) which are quoted in this brief under Point 4, b, *supra*. There has been, however, comparatively little judicial discussion, in rate regulation cases, concerning what are *fair* competitive conditions that create and maintain a *fair* market. Yet "fair prices" and "fair values" can not be found anywhere except in a fair market. If such prices are to be established by law (instead of being fixed in an *actual* market) the rate-making legislative power must choose: either to create an *actual* market by establishing *actual* competition, or to create the *standard* of a free and fair market by assuming conditions of free and fair competition.

Such a standard has been stated by the Supreme Court of Illinois in the following language:

> "Fixing rates by public authority may secure to each individual the advantage of collective bargaining by all in behalf of the whole body of consumers and result in such a rate as might properly be supposed to result from free competition, if free competition were possible."
>
> *State Utilities Commission* v. *Springfield Gas Company* (1920), 291 Ill. 209, 218.

Is this standard of rate-regulation and value regulation inconsistent with any principle announced, or any decision made, by the Supreme Court of the United States? It is useless to follow counsel for the carriers through all the devious paths of argumentation whereby they seek to establish a legal *right* to charge unjust and unreasonable rates. It is unnecessary to comment upon quotations from judicial

opinions with which they seek legalistic justification for a violation of their legal *obligation* to charge just and reasonable rates. The question just stated still remains unanswered.

It is only necessary to review the holdings of the Supreme Court, from the decision in *Munn* v. *Illinois* down to date, to demonstrate that **this court has never held** that rates for public utility service must be based upon a valuation of property that would compel the users to pay a *monopoly* price or the *highest possible* price, or any price greater than the reasonable worth of the service to the users. Such a review appears in many recent opinions of this court and need not be duplicated here. There have been written, however, many opinions of the court, denying that a public utility has a constitutional right to charge more than the service is "reasonably worth" to the user; even though (according to some opinions) "reasonable" rates to the user may not always provide a "reasonable" profit to the seller. (See, for example, *Cotting* v. *Kansas City Stock Yards Company*, 183 U. S. 79.) But there has been *no* decision or opinion of the Supreme Court holding that rates would *not* be "reasonable" if they were fixed upon the basis stated by the Supreme Court of Illinois in the opinion just quoted.

Nor do we believe it can be fairly urged, or that this court will have much patience with the contention, that, if the private property of a public utility owner be given a value which the owner might reasonably expect to realize in a state of free competition, nevertheless, the owner's property might thereby be "confiscated," or that he might be deprived of a "just compensation" measured by "the established principles of private rights and distributive justice."

Therefore, it is submitted that, if the Interstate Commerce Commission, acting under its delegated authority to fix "reasonable" rates, has fixed such rates anywhere between monopoly prices and confiscatory prices (as here defined) with the object of establishing what may be called "fair competitive prices," the action of the Commission has been taken safely within the limits of its delegated power. If such "competitive prices" have been established, then "competitive values" for property must have been established also and the carriers cannot be heard to complain that their properties have a much greater "true value." A greater value could only result from giving the carriers a greater "power to command a price." Such a value could only result from assuming that the owners ought to be subjected to *less* than free competition in the furnishing of service. To make such an assumption would be equivalent to granting the owners a partially monopolistic power, thus awarding them a monopolistic value for their property based on a right conferred by law to charge monopolistic prices.

A Monopoly Price

A "monopoly price" is not necessarily as high as an "extortionate price," or a "hold-up price." The owner of a property right peculiarly necessary to a buyer may exact an extortionate price. But such prices are obtained in individual instances and rarely can be realized in a continuous course of business. A monopoly cannot count on gouging the public year after year by charging extortionate prices, because eventually public or private competition will develop, in furnishing either the same service or a substitute service. In addition to this threat of competition, there is another natural limitation upon a permanent policy of extortionate prices. Quite commonly larger profits can be

made by selling greater quantities of goods, or more services at a lower margin of profit, than can be made by selling smaller quantities for a greater margin of profit. Therefore, a monopoly, wisely administered, will not charge extortionate prices, but will charge the highest possible price consistent with the largest aggregate profit. Thus we may expect a "monopoly price" to be a little *less* than the present cost of duplicating the service (including a fair return upon the necessary investment), because if the price *equals* the present cost of duplicating the service, competition is almost inevitable. This fact is emphasized in Van Hise on Concentration and Control, pages 84-86, where the learned author quotes with approval a similar analysis of "monopoly prices" by Ely in "Monopolies and Trusts."

A Confiscatory Price:

A "confiscatory price," as here defined, is not as low as a "cut-throat" price. Such prices, which are less than cost of production and allow little or no profit to recompense the owners of property used, may develop temporarily where there is unregulated destructive competition. But in a condition of fair competition, it may be assumed that prices will not be reduced much below the level which will provide a fair profit. Yet, what sellers will regard as a fair profit depends largely upon current opportunities for investment and the returns obtainable on investment involving similar risks of loss and similar chances of gain.

In truth, competitive prices offer a wide range of possibilities, rising to enormous speculative profits and sinking to no profits at all. Vigorous criticism has been expressed concerning the results of the competitive price system and the unwisdom of attempting to regulate monopoly prices

upon the assumed basis of free competition.[1] This criticism, however, is based on the assumption that free competition may produce anything from speculative profits to loss of capital—which is true. There is, however, a range of competitive prices which may be regarded as "fair" which lie between the excessive and insufficient prices which we are defining now as "monopoly prices" and "confiscatory prices."

We have included within monopoly prices not only those competitive prices which result from a *complete* control of the market, but also those resulting from a *partial* control, in the interest of sellers. Likewise we must include in our group of confiscatory prices, not only those which result from a ruthless, destructive competition where sellers are striving principally to avoid bankruptcy in a market controlled by buyers, but also those unsatisfactory prices which result from a market *partially* controlled by buyers.

A Fair Competitive Price

Throughout this effort to define fair prices and fair competitive conditions, it has been evident that it is impossible to provide a formula or scientific test whereby accountants and statisticians can take a mass of data and merely by a series of computations produce figures representing fair prices. Even where there is active competition, a study of

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[1] "The attempt to carry over into the field of the large scale monopoly the same price system that is assumed to prevail in the field of the small competitive enterprise is bound to result in a serious misfit. One reason why it is a misfit is that the competitive price system disregards so ruthlessly the financial needs of the individual producer. To the low cost producer, it yields profits far beyond the current rate of interest on invested capital; to the high cost producer, it brings deficits that spell bankruptcy and ruin. As long as competition is full and free, this process, harsh though it be to the unfortunate producer, may serve very well the interest of the consumer. For what matters it to him that any one producer is crippled so long as he can turn to a more fortunate rival for his necessary services and commodities? Not so under monopoly. Not so with a railway that is alone in serving a community."

Bonbright, "The Economic Merits of Original Cost and Reproduction Cost."

Harvard Law Review, March, 1928, 593, 622.

existing market prices must be qualified by a judgment as to the fairness of competition, and the extent to which the bargaining power of sellers or buyers may have been aided by temporary, unfair conditions or by unjust use of political or economic power. Like every ethical problem presented for discussion and opinion, there must be taken into consideration the balancing and compromising of conflicting interests, the shifting currents of public and private interests, the necessities which arise from human weaknesses and incapacities; and the uncertainties which thwart all efforts to determine what are the ideal uses of human strength and capacity.

> "The boundary at which the conflicting interests balance cannot be determined by any general formula in advance, but points in the line, or helping to establish it, are fixed by decisions that this or that concrete case falls on the nearer or farther side."
>
> *Hudson County Water Co.* v. *McCarter*, 209 U. S. 349, 355.

It is seldom the ideally just, the mechanically perfect, solution which can be sought as an immediate object of political action. And so in the regulation of fair prices, one of the most difficult problems that can be presented for determination by officers of government, we have been forced in this country to lay down by legislation, and to support by judicial opinion, the vague standard of what is "fair" and "reasonable"; and to establish commissions composed of men who may be expected to think and act impartially upon intimate knowledge of the problems confided to them, and to arrive at a reasonable judgment. Then unless we permit a fair trial of the results it is practically impossible ever to determine the reasonableness or unreasonableness of the judgment exercised. The old human road of trial and error seems unavoidable.

As previously pointed out, any effort to coerce this administrative judgment, this exercise of legislative discre-

tion, by the establishment of formulas for the determination of what is "fair" and "reasonable" is simply an effort to destroy the substance of legislative power by denying to the legislative department the power to determine what property rights shall be conferred upon, and exercised by, private persons engaged in furnishing public service, which will be consistent with and not destructive of the public interest.

It is submitted that in dealing with the problem of rate regulation and value regulation which has been presented to the Interstate Commerce Commission for its solution in conformity with legislative standards which have been expressed in general terms, the Commission has exercised reasonably the legislative power delegated to it. To demonstrate this, the precise legislative standards provided must now be considered, and interpreted in the light of the general standards of rate-regulation heretofore reviewed.

PART III.

THE LEGISLATIVE STANDARDS FOR RATE REGULATION AND VALUE REGULATION.

Point 9.

In its exercise of the legislative power of rate-making Congress, in the Interstate Commerce Act, has authorized and directed the Interstate Commerce Commission:

(a) "To determine and prescribe what will be the just and reasonable" rates. (Sec. 15 (1).)

(b) To "establish or adjust such rates" so as to provide a "fair return upon the aggregate value" of railway property. (Sec. 15a (2).)

(c) To enforce a trusteeship imposed on every individual railroad in regard to net income exceeding the "fair return" upon the value of its individual property. (Sec. 15a (6).)

(d) To determine the aggregate value through its individual valuations "ascertained" through

"its investigation under Section 19a," giving "due consideration to all the elements of value recognized by the law of the land for rate-making purposes." (Sec. 15a (4).)

(Sections 15a and 19a are printed in full in Appendix C.)

There are two particulars in which the legislative action of Congress providing for regulation of transportation rates is to be distinguished from previous and customary rate regulation.

First, the basis of rate fixing is not the value of an individual property, but the "aggregate value" of many properties which are held in separate ownership.

Second, the rates fixed are expected to provide an excessive return for some property, a part of which is to be recaptured for public uses.

The effect of these unique factors in rate regulation is to demonstrate conclusively that the purpose in valuing an individual property is not to determine an absolute value, but is merely to fix an amount which will represent the value which the property should have for its owner in view of his legal obligation to charge only just and reasonable rates. Under the scheme of regulation adopted, a carrier not only may earn and retain 6% of the "value" fixed for its property, but it may earn *much more;* and it may retain one-half the excess earnings which are held temporarily in a reserve fund, which may be drawn upon to pay returns on property values in the form of dividends or interest or rent. But such reserve fund need not be maintained after it reaches 5% of the "value" fixed.

It should be apparent that the carrier's concept of one "true value" is wholly inapplicable to the methods provided for fixing values and rates in the Transportation Act of 1920. In *Dayton-Goose Creek Railroad Company* v. *United States*, 263 U. S. 456, counsel for the carriers made the following claim, according to the opinion of the court:

> "The value of property, it is argued, really depends on the profit to be expected from its use and should

> be calculated on the income from rates prevailing when the law was passed, which must be presumed to have been reasonable."

The court held that this argument was not open to the carrier on the record because the carrier had not made the issue before the Commission that the value reported by it to the Commission was not the "true value." As a result, it was held:

> "We cannot consider an issue of fact that was primarily at least committed by the act to the Commission, when the carrier has not invoked the decision of that tribunal."

Although the Supreme Court did not pass upon this "value" claim of the carrier, it must be clear that the claim could not have been sustained. If the "true value" of the carrier property must be calculated "from rates prevailing," then no excess income could possibly be recaptured and prevailing rates producing unjustifiable profits could not be reduced. On the other hand, if existing rates were insufficient for many carriers they could not be increased because, by the same circuitous reasoning, these rates would also provide a fair return on the value of the property ascertained by capitalizing the net income under existing rates.

But the claim of the carriers in the *Dayton-Goose Creek Case* did emphasize one fact in conflict with the present claims of the carriers, which is that "value" in the ordinary sense must depend upon earning power. Thereby, it is again made evident that the value to be fixed by the Interstate Commerce Commission is not the value that properties *have* under existing rates, or *might have* under rates which could be charged, but the value which they *ought to have* under reasonable rates.

The entire opinion in the *Dayton-Goose Creek Case* is illuminating in showing the many factors which must be considered by the Interstate Commerce Commission in fixing reasonable rates, in accordance with the existing law. Fur-

thermore, the opinion, in emphasizing that the carriers have no constitutional right to expect such profits as may be obtained from private enterprise, demonstrates clearly that the carriers have no constitutional right to have their properties valued on the same basis as properties would be valued when devoted to private business. Particularly it should be clear that the carriers have no constitutional right to have their properties valued on the basis of the highest possible values which could be obtained for properties devoted to private business.

> "The carrier owning and operating a railroad, however strong financially, however economical in its facilities, or favorably situated as to traffic, is not entitled as of constitutional right to more than a fair net operating income upon the value of its properties which are being devoted to transportation. By investment in a business dedicated to the public service, the owner must recognize that as compared with investment in private business he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit."
>
> (Dayton-Goose Creek Opinion, p. 481.)

We would point out that the obligation limiting the owners of public utility property "to only fair or reasonable profit" has the inevitable result of limiting the values of their properties to only "fair or reasonable" values.

The following further quotation from the *Dayton-Goose Creek Case* is most pertinent:

> "In the *New England Divisions Case* (*Akron, C. & Y. R. Co. v. United States*), 261 U. S. 184, 67 L. Ed. 605, 43 Sup. Ct. Rep. 270, it was held that, under par. 418, the Commission, in making division of joint rates between groups of carriers, might, in the public interest, consult the financial needs of a weaker group in order to maintain it in effective operation as part of an adequate transportation system, and give it a greater share of such rates, if the share of the other group was adequate to avoid a confiscatory result.
>
> "In both cases it was pointed out that the Transportation Act adds a new and important object to previous

interstate commerce legislation, which was designed primarily to prevent unreasonable or discriminatory rates against persons and localities. The new Act seeks affirmatively to build up a system of railways prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission, which is to supervise their issue of securities, their car supply and distribution, their joint use of terminals, their construction of new lines, their abandonment of old lines, and by a proper division of joint rates, and by fixing adequate rates for interstate commerce, and, in case of discrimination, for intrastate commerce, to secure a fair return upon the properties of the carriers engaged.

"It was insisted in the two cases referred to, and it is insisted here, that the power to regulate interstate commerce is limited to the fixing of reasonable rates and the prevention of those which are discriminatory, and that, when these objects are attained, the power of regulation is exhausted. This is too narrow a view of the commerce clause. To regulate in the sense intended is to foster, protect and control the commerce with appropriate regard to the welfare of those who are immediately concerned, as well as the public at large, and to promote its growth and insure its safety." (p. 477.)

When Congress sought by the Transportation Act, through the Interstate Commerce Commission, "to build up a system of railways prepared to handle promptly all the interstate traffic of the country," Congress dealt with the transportation system as a whole. As the court held later in the same opinion (p. 479):

"If Congress may build railroads under the commerce clause, it may certainly exercise affirmative control over privately owned railroads to see that such railroads are equipped to perform, and do perform the requisite public service."

Thereby, in fixing rates, the Interstate Commerce Commission could not avoid a constant comparison of the *actual* privately owned system with a *possible* publicly owned system designed to render the same service. The Commission could not avoid considering what rates would be necessary to support such a publicly owned transportation system, and in fixing reasonable rates the Commission would be forced to conclude that *reasonable* rates for service under private ownership could not greatly exceed such rates as would be reasonable under public ownership.

The Commission might well find it necessary to allow a larger *rate of return* for private capital than would be necessary to recompense public capital. But on what theory could the Commission assume that more *capital* would be required to develop a privately owned system than would be necessary to develop a publicly owned system?

Beyond this difference in rate of return what justification would the Commission have for increasing rates for privately owned roads above those which would be necessary to support publicly owned railroads? Certainly private enterprise does not claim that its operating expenses are actually greater than those which would be incurred by the government.

It seems therefore that the heart of regulation of rates in conformity with the provisions of Section 15a is the provision for valuation. Individual properties are to be valued but rates are to be based upon an aggregate valuation. Inevitably rates so fixed will give different earning powers to the individual roads. Some will earn more than the average fair return, some will earn less. The aggregate valuation measures the rate basis, not by the "value" of individual roads (in any ordinary definition "market value"), but by the value of a system of roads which are not under common ownership, and thereby comprehends not the "value" *to* the *individual owners*, but the

value of the whole system *as an instrument of public service*, which means essentially the value of the system to the users. The primary standard for the Commission fixed by the Transportation Act is to determine the reasonable worth of the service to the users.

Point 10.

The legislative power thus provided no formula for fixing reasonable rates, but required its administrative agent to obtain a vast amount of information, to consider it and to report it, so that the bases for its conclusions might be known. A mere reading of the Interstate Commerce Act will demonstrate the impossibility of establishing "reasonable rates" by any formula or—by the same token—the impossibility of establishing the "value" of railway property by any formula. "A reasonable judgment having its basis in a proper consideration of all relevant facts"—is clearly all that is possible. Such a judgment has been exercised by the Commission.

The report of the Interstate Commerce Commission in the present proceeding shows plainly the effort of the Commission to establish the value of railroad property upon such a basis that reasonable rates—that is competitive prices—would be established. The Commission obtained, considered and reported a vast amount of information, which would aid in finding a reasonable price for the service. The Commission obtained all the evidence available to show what the properties originally cost or might reasonably have cost, thus showing the investment which must have been made by the private owners in constructing the property, and indicating approximately the amount of investment which must have been made by the public if the property had been constructed by the government.

This evidence permitted the Commission to consider the bargain which *might* have been made between the government and private interests when the railroad was built. Government officials *might* have made an estimate of the cost and of operating expenses and might have given the private owners the alternative of offering to serve at rates which would be sufficiently profitable to support public ownership, stating that if the offer were not accepted, the government would build the road itself. Certainly the private owners knew when they built the road what would be the measure of reasonable rates if the government were to construct the identical road or to construct a competing road. They knew that they were competing for business with the government itself which can always furnish service without a greater "profit" than a fair return upon money invested.

The Commission also had before it the cost of reproducing the road at the time of valuation. Government officials at *that* time could have said to the private owners: "We can now duplicate this identical railroad and charge rates no higher than you would ask if you based your rates on the cost of duplication." And furthermore government officials could have shown that the *service* could have been duplicated at the time of valuation for lower rates than those based on the cost of duplicating the identical property.

In addition to all its information regarding the "costs" applicable to any particular property, the Commission possessed a vast amount of information regarding the entire transportation system, information obtained through regular reports upon operating and financial conditions, through thousands of investigations of requests for lower or higher rates, through years spent studying acres of statistics and tons of printed argument presenting innumerable factors of the conflicting interests of buyers and sellers. The Commission possessed information regarding competitive fac-

tors such as motor bus and motor truck transportation that are cutting into the revenues of the railroads.[1]

That all this information was considered is shown in the report of the Commission. There can be no question that the Commission sought most earnestly to exercise "a reasonable judgment having its basis in a proper consideration of all relevant facts."

And the Commission *knew* that the physical structures of the railroads did not *have* a "value" equivalent to their reproduction cost at present prices—no matter how the word "value" should be defined. The Commission *knew* that the railroads, individually and as a whole, did not *have* even a monopoly "value" remotely approaching the "value" claimed—for the very simple reason that the traffic would not bear rates based on such a "value"—so that if rate regulation were abandoned and monopoly allowed to control prices, the "value" claimed could never be realized.

In short, the Commission *knew* that the railroad claim, that the carriers had a constitutional right to have their properties valued upon a basis higher than their maximum earning power, was a gigantic hoax—a mere scheme for evading all legislative rate regulation, and for establishing an unregulated private power to squeeze the maximum private profits out of the furnishing of public service.

Finally the Commission *knew* (with the intellectual humility characteristic of well informed students of economic problems) that no human being could write a formula for fixing a fair price or a fair value for any property—and that under the provisions of the Interstate Commerce Act—with its multitude of obligations imposed on the carriers—with its multitude of duties and powers imposed on the Commission—the Commission must either actually exercise its "reasonable judgment" within the field of legislative

[1] The Commission had been admonished long ago that "all circumstances and conditions which reasonable men would regard as affecting the welfare of the carrying companies and of the producers, shippers, and consumers, should be considered by a tribunal appointed to carry into effect and enforce the provisions of the act." *Texas & Pacific R. R. Co. v. Interstate Commerce Commission*, 162 U. S. 197, 219.

discretion, and fix "reasonable values" as the basis for "reasonable rates," or else confess itself impotent to accomplish the purpose of its creation. The question really presented upon this record is not whether the judgment of the Interstate Commerce Commission shall be upheld, but whether the existence of the Commission shall be sustained. Stripped of any real power to exercise an independent judgment, exposed unprotected to storms of public criticism for failure to safeguard public interests, the Commission's reason for existence would disappear and its dissolution would be inevitable. The question is whether the substance or only the shadow of legislative power shall be preserved when there is an appeal made to the destructive powers of the courts.

PART IV.

THE DECISIVE ISSUE IN THE PRESENT CASE.

Point 11.

This reasonable judgment has been based on the principle that competitive prices should be high enough to support generously the credit of the carriers whose securities represent prudent investment, so that the existing facilities may be maintained efficiently and further investments may be induced—and not unreasonably higher than the prices which would have resulted if the public had undertaken to furnish the service or to compete fairly with private enterprise.

The reasonable judgment of the Commission, while based on the principle just stated, involved numerous compromises of the conflicting interests of the buyers and sellers of public service. These may be considered in the following order:

Structural Elements

(a) The Commission did not value the structural elements of the property on the basis of original cost, the exact

amount of which was not ascertainable. The Commission did find that "the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the 20 years preceding." Therefore, the Commission utilized this 1914 cost as evidence of the value of a railroad property in 1914, regardless of whether original cost or reproduction cost figures were used. In other words, whether the Commission had assumed that a competition existed from the beginning, or had assumed that government competition did not begin until 1914, the competitive price for service would be based upon the same amount.

Regardless of subsequent changes in the price level, there might be a sound basis for the use of a 1914 cost of duplicating the *service*, plus the cost of subsequent additions to the property. This was the year after the passage of the Valuation Act (Section 19a). The carriers were all informed by law that, whatever basis of regulation had prevailed in the past, from then on rates would be based upon a property valuation to be made and thereafter kept up to date. If the Commission had been able within six months to value all the railroads and to arrive at a permanent basis for rate regulation, it is hardly conceivable that the carriers would have objected to the valuation of their properties on the basis of the then existing cost of duplicating the identical properties.

Let us assume that, after such a valuation in 1914, the following proposition had been presented to the carriers: Will you accept the present valuation as the basis for rates? Or: Will you sell to the government for the amount of such valuation? It is hardly conceivable that the carriers would not have gladly accepted the valuation offer as a basis for rates. They could not have demanded a higher one on any theory. It is certainly clear that—if the carriers had stated that they would not accept such a valuation as a rate base,

but that, anticipating a rise in the general price level, they expected to ask year by year for a higher valuation and thereby for a larger profit on the existing investment—the government, faced with such an alternative, would have taken over the railroads in order to preserve reasonable rates.

Land

(b) In addition to a structural reproduction cost as in 1914, the Commission has included in the valuation of the carrier properties the value of land as of the date of valuation. Here the Commission has been liberal in the extreme to the carriers. The Commission's judgment has been influenced plainly by certain judicial opinions and also possibly by the following economic considerations: No one can reasonably claim that a composite physical structure has a market value equal to its cost of reproduction, unless in use the property has demonstrated such a value through its earning power. Factories, shops, commercial buildings and similar physical structures cannot be sold upon the basis of their cost, unless they have demonstrated in use an appropriate earning power. Strip them of their earning power and they have only scrap value. On the other hand, while the earning power of land likewise determines its market value, land has what may be called a naked value, far less dependent upon the ability of its owners to make it pay than are physical structures. A poorly designed, badly planned or located structure will be worth less upon completion than the cost of its fabrication. Perhaps a large part, or all, of the value of the structure must be destroyed in order to utilize profitably the land upon which it is placed. On the other hand, a piece of real estate has a value in itself, dependent more nearly upon surrounding conditions than the value of any structure.

It is true that a railroad cannot use its real estate for other than railroad purposes. It has been held by the Supreme Court and by other courts that land in the possession of a railroad has a value limited to its value for railroad purposes. (*C. B. & Q. Railroad* v. *Chicago*, 166 U. S. 226.) It is difficult to measure its value by the value of adjoining properties because if the railroad is taken away the value of adjoining properties is practically certain to change.

> "It might well be asked, who shall describe the conditions that would exist, or the exigencies of the owners of the property, on the assumption that the railroad were removed? • • •
>
> "The assumption of its non-existence, and at the same time that the values that rest upon it remain unchanged, is impossible and cannot be entertained."
>
> *Minnesota Rate Cases, supra*, pp. 451, 452.

It is difficult to value a railroad right of way by the values of adjoining farm lands because if the right of way were abandoned, its cinder and rock ballasted structure would not make the land available for agricultural purposes. While the railroad is in operation, the land can only be used for railroad purposes, so that any standard of valuation other than the actual investment made in the land seems difficult to apply.

However, for reasons which appealed to the Commission as sound, carrier land has been valued on the basis of the market values of adjoining land. Some justification for such a valuation appears to be found in the Minnesota Rate Cases, *supra*, where this court held as follows:

> "Assuming that the company is entitled to a reasonable share in the general prosperity of the communities which it serves and thus to attribute to its property an increase in value, still the increase so allowed, apart from any improvements it may make, cannot properly extend beyond the fair average of the normal

market value of land in the vicinity having a similar character. Otherwise, we enter the realm of mere conjecture" (p. 455).

It will be noted that this court held upon one *assumption* that the land could not have a value "*beyond* the fair average of the normal market value of land in the vicinity." Thus the Commission has given to the carrier land the highest possible value that would accord with the opinion of the court. In behalf of the users of public service, we may well protest that this is too liberal treatment because it is not fair to attribute to land held for railroad purposes under the obligations of public service the same values which might be realized from the comparatively unlimited property rights of the owners of property not devoted to public uses. Furthermore, we are observing from the development of air rights in the great city terminals that, where railroad land has a value which can be realized through private use, equal to that of adjoining properties, the owners of railroad properties seek and find the way to realize such values. It should be submitted that values which can only be realized by *private* development should not be found as values of property being devoted to public service.

The report of the Commission shows in detail how liberally the Commission exercised its reasonable judgment in valuing the carrier property for rate making purposes. Not only in the matter of land values but in many other details the Commission dealt so generously with the sellers' interests that the buyers of public service might well complain. On the other hand, they might feel that such a policy would be productive of better (if not cheaper) service in the long run. But if there is any objection in behalf of the buyers to the report of the Commission, because of its liberal regard for the interests of the sellers, that objection should properly be presented to the Commission with a re-

quest for a different exercise of its reasonable judgment. We are not asking the court to substitute its judgment for that of the Commission; but on the contrary we are seeking to point out that, without agreeing with every conclusion of the Commission, one may properly urge that its authority to exercise judgment should be upheld.

The report itself contains the best statement of the factors considered by the Commission in its exercise of judgment. It is significant that of the four dissenting Commissioners one (Commissioner Aitchison) unreservedly opposed the valuation rule contended for by the carriers, as a matter of public policy, but expressed himself as constrained to follow a rule, which he felt had been "laid down by the Supreme Court." Another Commissioner (Commissioner Hall) seemed to base his dissent entirely upon a supposed judicial rule and not upon his own judgment of what the rule should be to produce "reasonable rates." A third dissenting Commissioner (Commissioner Woodlock) stated that "the main purpose of regulation of public utility enterprises is to supply to the public that protection in the matter of rates, fares and service which is supplied in the case of freely competitive and therefore, unregulated—enterprises by the force and play of competition. In fully competitive enterprises, the rate of return tends, at all times, to circle around the point where it will just suffice to attract capital into the industry when and as needed." Therefore, this Commissioner seemed to agree with others that the principle of competitive cost of service should provide the basis for determining reasonable prices, but to disagree with his colleagues, not upon the theory advanced by counsel for the carriers, but upon the application of the principles of the majority. The fourth dissenting Commissioner (Commissioner Taylor) expressed his dissent for reasons which cannot be summarily stated with fairness. But at least they did not appear to be based on leaving out

of consideration the necessity for establishing reasonable rates. (R., 37-69.)

Thus we find the entire Interstate Commerce Commission attempting a solution of the problem presented upon the principle that rates should be sufficient to maintain existing facilities efficiently and to induce further necessary investments. And we find a large majority, if not all the Commissioners, in agreement with the principle that competitive prices measure fair prices. Also, we find a substantial majority of the Commission—as shown by the opinions of Commissioner Meyer for the majority and Commissioner Eastman concurring (with whom Commissioner McManamy joined)—exercising the reasonable judgment required of them for the primary purpose of establishing such rates as would, in their opinion, promote the maintenance and extension of "an adequate national railway transportation system" with the purpose of providing for that "treatment of capital already invested, which will invite and encourage further investment." (R., 64.)

It must be clearly apparent from the report of the Commission that rates in the future (fixed upon the basis approved by the majority) will increase, rather than diminish, the present profits of railroad owners. And the Commission reports from its intimate knowledge of the facts that "the credit of the railroads in general is now excellent" and that, "with exceptions in certain sections of the country, it will be conceded that the railroads are now in better credit and financial condition in all probability than at any time in their history." As to the exceptional sections, the majority reports that "the need for improvement in such situations is due not to any deficiency in the aggregate values which we have used as a base in general rate cases, but to failure to earn a fair return upon such values." (R., 67-68.)

The question therefore presented is: Have not fair competitive prices been fixed so far as the ordinary tests of competitive conditions can be applied?

(a) **It would seem to be conclusive proof that rates have been fixed within the range of legislative discretion (between a monopoly price and a confiscatory price) if experience shows that the traffic continues to move in a reasonable volume and that additional investments continue to flow into the public service at reasonable rates of return.**

The report of the Commission shows that in certain sections of the country the traffic at present moving does not supply an adequate return upon those values which the Commission believes the railroads ought to realize in their properties. It is a matter of common knowledge, without specific reference to the reports of the Commission and resolutions of Congress, that there is grave complaint in these sections of the country that the rates are, at present, higher than the traffic will bear. In these sections of the country, the carriers themselves have not asked that rates should be fixed upon any value even approaching the values to which they claim to be entitled. (113 I. C. C. 3.)

On the other hand, the Commission finds that additional investments are flowing into the public service for extension and improvement of railroad facilities at an increasingly satisfactory rate. How can it be claimed, in view of these elements of value, concerning which the Commission is fully informed, that these railroads should be given higher values as a basis for fixing higher rates, when there is the gravest question as to whether higher rates would improve net revenues? Therefore, there is the gravest question as to whether any higher values could possibly be realized in the existing properties, than those which are now being placed upon them.

It can hardly be suggested that the traffic *volume* would increase under higher rates so the only question that might

be presented concerning the reasonableness of the rates fixed would naturally arise from a complaint on the part of shippers urging that at lower rates a larger volume of traffic would move. Such a complaint might well include evidence that even larger profits would be made at lower rates.

Thus it appears that this case involves no contention that present rates *should* be higher, although a demand for a higher rate base is a demand for higher rates. The present contention of the owners of a railroad property is that they are entitled to retain more of the surplus being earned upon existing rates and is based primarily on the unsound and indefensible theory, that there is an absolute value in their property which exists independent of their obligation to charge reasonable rates. We have previously sought to demonstrate that such a claim is insupportable and we now point out that if the rate base for existing rates is too low then existing rates must be too low. But, any claim by this carrier that present rates in themselves are too low would be answered by a mere statement of the gross revenue obtained from such rates, which is generous under any conceivable theory of competitive rates.

Another objection of the carriers to recapture of excess earnings may be based on the argument that they should not be required to hold in trust returns in excess of 6%. The constitutionality of a 6% return upon a fair value was not directly passed upon in the Dayton Goose Creek Case, supra, but the court referred to the fact that a 6% return had not been found confiscatory in several cases cited at page 486 of the opinion; and it is notable, as pointed out by Mr. John Bauer in June, 1924, that—

> "In the entire history of rate cases before the court, there has not been a single case where rates that yielded as much as 6% upon actual investment were held confiscatory. Where the rates have been declared invalid, they either were insufficient to yield even oper-

ating expenses, or brought about such a low return on the properties that they could not be justified on any basis." (American Economic Review, Vol. 14, No. 2, p. 262.)

However, since a carrier would receive the same amount of money from 6% upon a value of $1,000,000, as the carrier would receive from 12% upon a value of $500,000, it is impossible to avoid a discussion of what the rate base should be, by discussing merely the percentage of return which has been obtained upon the rate base that has been fixed. We cannot avoid the practical question of determining whether additional investments will continue to flow into the public service at the rate of return provided for those investments. We are driven inevitably back to considering whether the investors of capital are receiving what *should be* reasonably satisfactory returns upon their investments.

But, when considering the rates, the returns and the values which *should be* satisfactory to the owners, the Commission must always consider the actual and potential competition, both from public and private sources, which must be or ought to be met, because, in the first place, it may be impossible for the railroads to realize higher or monopoly values; and, in the second place, it would constitute an abandonment of the power of rate regulation for the Commission to establish such values as the basis for rate making.

When complainants seek a judicial review of the judgment exercised by the commission, then if the commission has proceeded with care and deliberation, acting upon principles and according to methods which show the desire and intention to deal fairly with all conflicting interests, it should be clear that the *best* evidence and practically the *only reliable* evidence of the reasonableness of the Commission's action can be obtained after rates have been given

a trial—after the satisfaction of investors has been determined by their willingness to continue to make investments for the returns which are reasonably to be expected; and after the satisfaction of the users of service has been determined by the maintenance or increase of the volume of traffic.[1]

(b) If rates or values established are attacked as "confiscatory", before an adequate experience has been had to demonstrate their effect, the court is called upon to decide (upon the record) that the owners of the property involved would not have undertaken to furnish this service, and would not now continue to furnish it, voluntarily, for the price which has been fixed.

When we turn to the record of the particular case now before the court, any claim that unfair, competitive prices have been fixed, so that a carrier is being denied a fair competitive value for its property becomes insupportable. The earnings permitted to the O'Fallon railway after the recapture of the entire amount sought were so far above the average earnings in a competitive business furnishing a product or a service in similar continual demand (that is, in a stable, safe enterprise where there is full, free competition), that the claim that property is being confiscated becomes ludicrous if the present railroad *alone* is considered.

Upon the record of the present case, two of the judges held there could be no confiscation because even upon the value claimed by the carrier, the return varied to from 6.97% to 8.71%. The third judge took this position: Six per cent on $1,350,980, (the value claimed by the carrier) is $81,052.44. The net income for the year 1922 was $165,123.47. The carrier claimed that when $81,052.44 (the 6% return on its claimed value) was deducted, $84,071.03 was left subject to recapture.

[1] The principle of withholding judicial action until after a "full and fair test" of "practical experience," was approved in: *Willcox v. Consolidated Gas Co.* 212 U. S. 19, 50; *Cedar Rapids Gas Light Co. v. Cedar Rapids*, 223 U. S. 655, 659; *Louisville v. Cumberland T. & T. Co.*, 225 U. S. 430; *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, 172; *Darnell v. Edwards*, 244 U. S. 564; *Lincoln Gas & Elec. Co. v. Lincoln*, 250 U. S. 256; *Brush Elec. Co. v. Galveston*, 262 U. S. 443, 446.

One-half of this is $42,036 in round numbers. But the Commission sought to take $53,195. (R., 142.)

If, as pointed out by Judge Faris, the Commission was entitled to recapture only $42,000 and sought to recapture $53,000, there was a clear confiscation of $11,000. But such a contention can only be based on the assumption of an absolute right in the carrier to a 6% return upon an absolutely fixed value. Such a contention must be based, as heretofore pointed out, on the claim that reasonable rates are to be computed mathematically and do not involve the exercise of a reasonable judgment and that an absolute value of public service property exists independent of the obligation to furnish service at reasonable rates. But if it be accepted as an economic fact and as a legal principle, in accordance with the argument of this brief, that reasonable rates are only to be determined on the basis of what the value of property *should be* (since it possesses no absolute value and no applicable "market value") then it is necessary in the present case, as in every case, to consider the result of the Commisison's determination of reasonable rates, in order to see whether the resulting value is a reasonable value.

We find that in the present case after deducting the amount to be recaptured for the year 1922, the carrier had a net operating income of $111,927.95. Thereby the rates established by the Commission as reasonable rates netted to this carrier for the typical year 1922, 8.29% on the value claimed by the carrier and over 11% on the value fixed by the Commission. (R., 142.) Under the law the carrier is not required to hold more than 5% of the value of its property in a reserve fund so that, except for the excess of this one year, all the unrecaptured returns in excess of 6% are available to this carrier for any use which it desires. Therefore, on the basis of the carrier's own claims of value, it is difficult to see how any part of its property has been confiscated when the record of this case alone is considered.

There is, however, this factor of which the court may take judicial notice. The result of the principles of valuation, or more properly speaking, the principles of rate making, adopted by the Commission, will not produce for all railroads the same effect. Some may receive greater returns on the claimed values of their properties, some may receive less. If the principles here adopted are not sound, so that they could not be applied to all carriers, it must follow, as pointed out by Judge Faris, that this carrier would be deprived of money to which it would be entitled on the basis of the rate making and valuation principles to be applied to the carriers in general.

It seems apparent that this case cannot be argued upon the treatment of this carrier isolated from other carriers. Therefore, we are forced back to the broad question presented, as to whether, in dealing with the entire transportation system, in the light of its intimate knowledge of its requirements and of public needs, the Commission has adopted principles of rate regulation which are inconsistent with the fixing of a fair price for the service, as a compromise of the conflicting interests of the buyers and sellers. Can the methods of rate making and valuation exhibited in this case be applied to the carriers as a whole without establishing confiscatory rates and values?

Upon this issue we are forced to take one of two positions: Either (1) the present record is inadequate for the proper presentation and consideration of this issue and therefore the relief sought must be denied, or, (2) we must determine upon the basis of the present record and such further information as may be assumed to be within judicial knowledge, whether the methods of rate making and valuation here exhibited inevitably denied to the carriers as a whole just compensation. Reviewing only the record as to this particular carrier, it is clear that, if this were a single utility standing alone, no claim could be made that the rates which have been fixed (including the application

of the recapture provision) require *this* carrier to furnish service for an unreasonably low compensation for the use of private property, whereby its property is being confiscated. Therefore, it appears that the order of the Commission must be sustained on the record as applied to this individual carrier; and the only possible basis for setting it aside lies in the contention that a similar treatment of *all* the carriers will inevitably result in the confiscation of the property of *some* of the carriers. Thus we find that the decisive issue in this case is not one of fact but of economic theory—of public policy—and we must submit that unless the economic theory and public policy expressed in the report of the Commission is (1) contrary to legislative will; or (2) the result of an unconstitutional legislative act—it is not subject to revision by the exercise of judicial power.

Point 12.

This reasonable judgment is to be exercised within a "range of legislative discretion" by a tribunal appointed by law and informed by experience", and the Supreme Court has held that it does not sit "as a board of revision to substitute our judgment for that of the legislature, or of the Commission lawfully constituted by it, as to matters within the province of either."

The Supreme Court has never defined the measure for the "reasonable judgment" to be exercised by the Interstate Commerce Commission in valuing the railroads in conformity with the requirements of the Interstate Commerce Act. But in the *Minnesota Rate Cases*, *supra*, the court held:

> "The rate-making power is a legislative power and necessarily implies a range of legislative discretion. We do not sit as a board of revision to substitute our judgment for that of the legislature, or of the commission lawfully constituted by it, as to matters within the province of either." (p. 433).

Previously the Supreme Court had stated, and then affirmed, its attitude toward the Interstate Commerce Commission in these words:

> "The findings of the Commission are made by law *prima facie* true, and this court has ascribed to them the strength due to the judgments of a tribunal appointed by law and informed by experience."
>
> *Illinois Central Railroad Co.* v. *Interstate Commerce Commission*, 206 U. S. 441.
>
> *Interstate Commerce Commission* v. *Union Pacific Railroad Co.*, 222 U. S. 541.

The law above declared is well settled, but its application is the subject of perennial disagreement. The carriers contend that the reasonable judgment of the Commission and the range of legislative discretion should be circumscribed by a judicial formula for ascertaining value. It is our contention that the reasonable judgment is to be exercised in the very matter of establishing what the value of carrier property should be; and that the range of legislative discretion comprehends the establishment of any appropriate value which will not result in authorizing either monopoly prices or confiscatory prices for the use of property. We have heretofore discussed the principles whereby our contentions are justified. We contend that, whether these principles are applied to the facts involved in the particular case under discussion, or to the facts involved in regulating transportation rates throughout the country their soundness is equally demonstrated.

Point 13.

But, in the present case, the carriers are seeking to avoid all discussion of a fair price for the service, by claiming that a property value exists independent of, and not to be affected by, their obligation to serve at a fair price.

The contentions of the carriers may be expressed in the language of their last brief filed in the lower court:

> "The true value, that is, the economic equivalent of the property, must be ascertained in a way to determine the worth as of the time of the controversy, that is the then *present* value. This requires that effective and dominant consideration be given to the then present prices." (p. 13.)

Replying to the contention that the obligation to serve at reasonable rates should have a controlling influence upon any findings of value, counsel for the carriers assert:

> "Stripped of its trappings, the contention really is that the findings of value should be controlled by the rates which the Commission, on considerations other than those defined in the statute, thinks should be made effective." (p. 54.)

The false implication injected into the foregoing statement is that the Commission has acted "on considerations *other* than those defined in the statute." The fact is that the statute requires the Commission to establish "values for rate-making purposes" (Sec. 15a, 4), and requires the Commission to do this "in the exercise of its power to prescribe just and reasonable rates." (Sec. 15a (2).) Therefore the Commission is positively directed to establish only such values as are consistent with the charging of just and reasonable rates. The main consideration, "defined in the statute," should have been given *no* consideration, according to the arguments of the carriers.

Point 14.

The carriers contend that their property has a "true value which is the economic equivalent of the property", which value "must be determined" by giving "dominant consideration" to a theoretical cost of reproduction at "present prices."

In addition to the quotations from the carriers' reply brief in the lower court, which are printed under Point 13, a further quotation will clarify the railroad argument:

> "Viewing the issue from the point of either economic theory or plain common sense, we assert with confidence that the O'Fallon Railroad, because of its demonstrated earning capacity, is worth not less than its cost of construction at prices existing after the war. This is because it would have been built at those costs. Its abundant earnings would pay an ample return upon them." (p. 47.)

In the words just quoted counsel for the carriers complete their picture of a "true value" of property—which must be found without considering what are reasonable prices for the service rendered—but which is a value which they can "assert with confidence" *because* of the "demonstrated earning capacity" of the property. Yet this "demonstrated earning capacity" arises from rates based on a valuation method which they denounce as "confiscatory." When "confiscatory rates" produce such happy results the carriers should logically welcome the fixing of "confiscatory values" in order to insure a continuance of present prosperity!

The other reason for asserting "with confidence" that reproduction cost at present prices measures the "value" claimed for this property is "because it would have been built at those costs." In other words it is claimed that earnings under present rates prove the existence of a value

equal to reproduction cost, because in order to earn such profits investors would gladly reproduce the identical property at present prices.

But how does this prove that present rates are reasonable or that the value claimed is the one "true value"? "Common sense" seems to have led the advocates away from logic.

Point 15.

No property has any independent, or "true", value—or any "economic equivalent"—which is measured by reproduction cost or any other cost. Earning power—not cost—is the measure of value; as the Supreme Court has always held. Costs only furnish evidence of what would be a "fair price" for the service to recompense the seller for his outlays. Reproduction costs are only evidence of the highest possible prices—evidence of monopoly prices.

As covered in the argument under Point 4a, the ordinary economic value of property to its owner, that is, the owner's power to command a price, cannot possibly be measured by either cost of production or reproduction. All pecuniary values in the ordinary sense must be determined by earning power. The very question here involved is: What is a reasonable earning power? Therefore, the value of the property cannot possibly be determined until we have fixed the standards for determining what is a reasonable earning power.

Here we find an intelligible basis and one which is legally and economically sound, for the use of cost figures in seeking to decide what are reasonable prices to be charged for the service rendered, and thereby seeking to establish what value the owner of the property may reasonably expect to

realize out of furnishing the service. We find it not only useful but necessary to consider the cost of furnishing the service.

Let us consider this proposition first: The legislative power may enact a law providing that all persons seeking to furnish a public service shall be required as a condition of their franchise to agree that they will furnish service at cost, including in that cost reasonable operating expenses, a reasonable allowance for depreciation and a fair return upon the capital actually invested, allowing for such fair return an amount sufficient to pay the interest upon borrowed capital and such a return upon proprietary capital as will induce all necessary further investments. There can be no question that such contracts can be made *legally* and there can be no question that such contracts can be made *practically* because it is a matter of common knowledge that a large number have been made.

Therefore, our first proposition is that capital can be obtained for the promotion of public utility service under private ownership for a reward limited to a fair return (according to current market rates) upon actual investment. The second proposition presented is whether in the absence of special contract, owners of public utility property would voluntarily accept a fair return upon actual investment as adequate compensation for the use of their property.

The answer to this question is found clearly written in the history of public utility regulation. The owners of public utility property for years *demanded* from the legislatures and the courts that they should have a fair return upon actual investment. At the very time when the valuation basis was being stated in the courts, as in the language of *Smyth* v. *Ames*, the privately owned public utilities of the nation were everywhere demanding that their prop-

erties should be given a value equal to the actual capital investments made in them.

Ames v. *Union Pacific Railway*, 64 Fed. 164, 177.

San Diego Land Co. v. *National City*, 174 U. S. 739.

San Diego L. & T. Co. v. *Jasper*, 189 U. S. 439.

Stanislaus County v. *San Joaquin, etc., Co.*, 192 U. S. 201.

And the Supreme Court held:

"The rule stated in *Smyth* v. *Ames* is undoubtedly sound as a general proposition that the railroads are entitled to a fair return upon the capital invested."

Minnesota & St. L. Ry. Co. v. *Minneapolis*, 186 U. S. 257.

It is notorious, and reference is made in the opinion of the Commission in this case to the fact, that in the State of Massachusetts rates of local utilities have always been regulated upon the basis of actual investment and there has been no want of private capital anxious to furnish public service upon these terms.

From these first two propositions, we are led to the inevitable conclusion that privately owned and operated public utility service can be obtained, under legislative regulation providing that the owners of property so devoted to public service shall be permitted to realize only such values of property as result from rates which allow only a fair return upon actual investment in computations of the cost and value of the service. Two questions remain for consideration: First, is there any reason for rejecting the experience of the past and determining now as a matter of public policy that rates permitting only a fair return upon investment will not be adequate to induce future investment, and by the same token not adequate to recompense sufficiently past investment. Second, has Congress in fact authorized the Interstate Commerce Commission to establish the principle that the amount of investment should be the dominant consideration in determining what the value of railroad property should be for rate making purposes.

Reproduction Cost Fallacies

The first question presented requires a brief review of the arguments in favor of reproduction cost.[1] We have previously discussed at length the fallacy in the claim that there is one true value of property and the further claim that the infallible measure of such a value is the reproduction cost of the identical property. We propose now to discuss what seems to be the real issue in this case between the carriers and the Commission, which may be phrased as follows: Is a service *reasonably worth to the user* the cost of reproducing that service and therefore should property devoted to furnishing a service be valued at its reproduction cost, in order to ascertain the *fair value of the property to the owner*.

Many writers have pointed out the error in confusing reproduction cost of a *service* and reproduction cost of an identical *property*. It would seem unnecessary to urge at length that the reproduction cost of an identical property, and the reproduction cost of a property capable of producing the same service, are utterly different conceptions, particularly where the property in question has been developed over a long period of time wherein great changes have taken place in methods of construction, in the service demands of the community, in the facilities available for satisfying these demands, and in all the commercial conditions which determine the service to be supplied and the means available to furnish it.

The developments in the transportation industry in the last 25 years (to say nothing of the last 50 years) have been so swift as to be called revolutionary. Light engines have been replaced with heavier engines. Short freight trains by long freight trains. Roadways and bridges con-

[1] One of the most complete answers to all the reproduction cost arguments is found in *The "Physical Value" Fallacy in Rate Cases*, by Robert L. Hale, XXX Yale Law Journal 710

structed to handle modern traffic today bear little resemblance to the roadways and bridges of 25 or 50 years ago. Terminals bear little resemblance to the terminals of 25 years ago. Switching yards, roundhouses are entirely different. There is a great mileage of electrically operated railroads demonstrating that if the present transportation systems were to be replaced today, an enormous percentage of existing steam mileage would be electrically operated, and electric locomotives would replace the steam engines now in use.

Not only have great cities and small towns developed in such a manner as to make desirable relocations of railroad properties, but changes in the uses of vast areas of land show today that the steel rail highways would be laid out along different lines than existing lines if the entire service were to be duplicated in the most efficient manner. Existing railroads have spent enormous sums in straightening curves and removing grades. In some parts of the country, there is a clearly unnecessary duplication of facilities. Some parts of the country have yet inadequate transportation for their proper development. If a comprehensive transportation system were planned today, it is inconceivable that any substantial consideration would be given to duplicating the identical properties of the various railroads. It is impossible to sustain the contention that the cost of duplicating the present properties of the railroads furnishes a measure of the cost of duplicating the service and therefore furnishes a measure of the reasonable worth of the service to the users, according to any economic theory.

But if we disregard the horrible gap existing between a theoretical reproduction cost of the *identical properties* and a theoretical reproduction cost of the *service*, if we assume that a somewhat diminished reproduction cost of the identical properties might be taken to represent the present cost of reproducing the service, we will still be faced with the question: Is the reproduction cost of the service a

fair measure of what the service is reasonably worth to the users? The only basis for contending that the reproduction cost of the service furnishes any measure of the worth of the service to the user is that, under the harsh conditions of ruthless competition, private enterprises can, where they have a seller's control of the market, compel buyers to pay prices a little below the level of the cost of duplicating the service—because at such prices *new* competition can be discouraged.

In other words, prices based on the arbitrary cost of a new competition are essentially monopoly prices. If there is an old, persistent competition, the cost of duplicating the service (that is, the cost of new competition), exerts little influence upon the prices. The old competitors, so long as they do not get together in price fixing, will not be able to increase prices so as to provide more than a fair return upon their actual investments. It is quite clear that if some men in a competitive industry are satisfied with a 10 per cent profit, others cannot increase prices to make a 20 per cent profit. But it is true that if all of these competitors can get together and agree upon prices providing a 20 per cent return, they may be able to maintain such prices, if the cost of duplicating the service is such that a new competitor could only make 10 per cent upon the necessary investment.

Thus we see that the sole use of reproduction cost, as a measure of the value of property, is to measure the cost of a *new* competition. It provides no measure of the value of property under a *continuing* competition.

From the foregoing analysis we arrive at the crux of the present problem. If we assume that public utility rates are to be fixed as competitive prices, the measures adopted for fixing rates and for fixing values will depend largely upon whether we assume (1) that we are fixing the rates which a new competition could compel, or (2) that we are fixing the

rates which would prevail if there had been a continuing competition.

This issue is clearly presented in the present case. The Commission has fixed the values of railroad property at an amount *exceeding* the cost of duplicating the identical properties in 1914. If, therefore, we assume that in 1914 prices had been fixed upon a competitive basis the highest possible rates would have been based upon 1914 reproduction cost, plus 1914 land values. No higher rates could possibly have been fixed with any regard for the public interest in 1914, because the public could have duplicated the entire transportation system for less money and furnished a better service at lower rates. If public ownership had not been desired, private interests could have been authorized to duplicate the entire service and could have furnished a better service at lower rates. Therefore, if we assume a *continuing* competition (even since 1914, ignoring the more proper assumption of a potential competition from the beginning) we will find no possible justification for fixing rates today upon the basis of the assumption that competive prices today would be based on the present cost of duplicating the service.

It is submitted that the entire position of the carriers depends upon the unjustifiable assumption that privately owned public utilities have never been subjected to any potential competition. The position of counsel for the carriers depends upon the assumption that they have today in the aggregate a monopoly of the transportation service, that they are entitled to charge for that service the highest possible monopoly prices, that is, they are entitled to charge the rates which must be charged by anyone *now* seeking to duplicate the service they are able to perform.

According to this theory, every public improvement which increases the cost of duplicating the service adds an additional monopoly value to the existing properties. Yet it is precisely this argument which the Supreme Court declined

to follow in holding that the theoretical cost in removing pavements over gas mains could not be included within the reproduction cost of such mains. (*Des Moines Gas Co.* v. *City of Des Moines*, 238 U. S. 153.) It is this same argument which the Supreme Court again refused to sanction in the Minnesota Rate Cases when the carriers sought to have a monopoly value fixed for lands and the court refused "to attribute to the property owned by the carriers a speculative increment of value over the amount invested in it and beyond the value of similar property owned by others, solely by reason of the fact that it is used in public service." (*Minnesota Rate Cases, supra*, p. 454.) We have heretofore pointed out that there may be a value in land less dependent upon use than the values of other properties. A piece of land unprofitable for a retail store may be profitably improved with a machine shop, but a building designed for a retail store cannot be used as a machine shop. For the same reason we may assume that the owner of a valuable piece of land, finding it unprofitable for railroad purposes could turn it to more profitable uses. But we cannot assume that a stone ballasted right of way carrying iron rails (or the locomotives and cars that operate on it) can be used for anything except railroad purposes. Nor can we assume that railroad land should be given the same value as private land that can be sold for any purpose, when the railroad owner has no right to sell it.

But, for the reasons indicated, it may be contended that railroad lands have values which could be realized by charging monopoly prices against private persons. Hence the argument may follow that monopoly prices for the use of this land may be charged against the public. But no one can contend that railroad physical structures have any monopoly value that can be obtained from anyone *except* the public. Therefore, while we may protest that the obligations of public service should prevent the realization of monopoly values, even from land devoted to public purposes, we can urge with even more force that if monopoly prices are to be

authorized for the use of property which can not be used profitably for anything except railroad purposes, then the legislative power of rate regulation is absolutely nullified and ought properly to be abandoned. If public utilities are to be authorized to charge the highest possible prices for public service, the alternatives presented to the public do not include the regulation of public utilities. The alternatives are either submission to unrestrained private exploitation of the public service, or active public competition with all such existing services. If the public cannot regulate rates so as to obtain reasonable competitive prices through legislative action, then the public must either abandon rate regulation or resort to actual competition as the means for obtaining competitive prices.

Recognizing these alternatives, the Interstate Commerce Commission has made an effort to exercise the alternative power of rate regulation, which has been delegated to it, in such a manner as to produce those competitive prices which alone could have been the object of legislation. This is the only possible construction of the power delegated which is consistent with the assumption of a faithful performance of public duty by Congress. To suggest that the object of rate regulative legislation is merely to sanction and enforce the charging of monopoly prices, is to assume either stupidity or betrayal of trust by legislators. It is pertinent to point out that the alternatives above suggested are those which have been recognized at once as the only alternatives in the State of Massachusetts where the legislative power has been faced with the possible nullification of an effective power of rate regulation by judicial interference; and where as a result the department of public utilities has recommended that if rate regulation under judicial control is made "too cumbersome, inefficient and expensive to be tolerated" public ownership and operation is the necessary alternative.[1]

[1] See concurring opinion of Commissioner Eastman in the report of the Commission now under review (R., 87.)

Point 16.

Through the device of claiming that an absolute value inheres in their possessions, the carriers are in fact asking the court: to establish a formula for fixing the value of their property; and thereby to establish a formula for fixing rates; and thereby to take away from the legislative branch of the government all substance of its constitutional power to fix rates, in order that only a fair price shall be charged for public services.

Point 17

The carriers are asking the court (actually but not candidly) to establish a fiat value for all public utility properties at the amount of their theoretical production cost —to substitute a judicial formula for legislative discretion—to transfer the legislative power of rate-making from the legislatures to the courts; and by judicial action to establish monopoly values for these properties as the basis for a constitutional right to charge monopoly prices.

These points merely sum up the preceding arguments and call for no further exposition. But it may be useful to recall attention now to the unsound bases for the contentions of the carriers.

Point 18.

The contentions of the carriers are based on (1) a false economic concept of "value", which the court is asked to adopt against the protests of all authoritative economists; and (2) a false juristic concept of "property", which the court is asked to adopt in repudiation of its own opinions and the consensus of legal commentators.

It must be apparent that the entire argument of the carriers is based upon their claim that there is one "true value" for all property, one "economic equivalent" which

can be ascertained as a fact without recourse to market prices or without considering actual earning power. This one "true value," according to their contentions, bears an absolute relationship to certain costs which can be ascertained from prevailing market prices. These costs are the prevailing market prices of all the component elements of a physical structure, together with the cost of assembling these elements, together with the cost of getting the physical structures in motion and creating the business necessary to keep them profitably in motion.

Upon this theory of the carriers every man's property today would have a value equal to the cost of reproducing the identical property, together with all costs necessary to make out of the physical elements a going concern. If all property had such a value, there would seem to be no further need of bankruptcy courts or receiverships. There would seem to be no further need for competition to determine prices. There would seem to be no further need for bargaining, because the value of any physical structure at any time could be ascertained by a mere process of ascertaining reproduction cost, according to the formulas for which counsel for the carriers are here contending.

If this concept of "value" put forth by the carriers had any validity, it would act as a universal solvent for the economic problems of the world. The discovery of the fabled "philosopher's stone" could not have a greater effect upon economic conditions than the discovery of a formula for ascertaining the value of property—such as counsel for the carriers are now seeking to have announced as the law of the land.

There is no one true value for any property. The claim that there is such a value created by *economic law* would be preposterous nonsense were it not for the menacing fact that economic values *can* be created by *political law*. A monopoly can be granted by law, maintained and protected

by law; and a monopoly value can thus be given to private property. The formula which counsel for the carriers seek to have announced as the law of the land is a formula for creating a monopoly value. Yet the public policy of this government, expressed in thousands of statutes and decisions, is a policy that monopoly values shall not be given to private property. Our public policy is that, if monopolies are permitted to exist, they shall not charge monopoly prices and the properties of monopolists shall not be granted monopoly value. Yet counsel for the carriers seek to have this policy reversed by an exercise of an assumed judicial power to declare a public policy contrary to the established public policies written in constitutions and statutes by the legislative power of the people and their representatives.

In addition to a false economic concept of "value," counsel for the carriers seek to defend their indefensible position by advancing a false juristic concept of "property," ignoring the developed thought of the last century, returning to a discarded sophistical theory of a "natural right" of property. They ask the court to hold, in effect, that private property in possessions devoted to public use, is the same "bundle of rights," having the same "value," as private property in possessions not devoted to public use. They ask the court to hold that a property right to furnish goods or services at reasonable prices is the same right and has the same value as a property right to furnish goods and services for the highest prices that can be squeezed out of buyers.

We have sought to show heretofore, particularly under Points 4a and 4b that this court has never sanctioned either the economic concept of "value" or the juristic concept of "property" which are here advanced by counsel for the carriers. And we would further point out that, even if counsel for the carriers were able to persuade the court to announce a formula for fixing the value of public utility

property which in apparent effect would establish a flat value for such property, such a value would disappear over night as soon as the legislative authority saw fit to exercise its undoubted power to furnish a competitive substitute service. It is only through the will of the sovereign that a monopoly value can be maintained for any property. The sovereign power in the United States to prevent and to destroy monopoly values rests primarily in the people and secondarily in their elected legislative representatives. It is to be expected that the judicial power will be exerted to uphold the public policy determined by the legislative power and not to establish a public policy in conflict with "the legislative will when expressed in accordance with the organic law." *C. B. & Q. Railroad Co.* v. *McGuire*, 219 U. S. 549, 565.

It is not without significance that the case last cited arose upon the objection of a railroad to a law passed for the protection of employes, which law, the railroad claimed, interfered with its constitutional right to exercise liberty of contract. But the opinion of the Supreme Court delivered by Mr. Justice Hughes answered this objection in the following language:

> "But it was recognized in the cases cited, as in many others, that freedom of contract is a qualified, and not an absolute right. There is no absolute freedom to do as one wills or to contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards. Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interest of the community" (p. 567).

In line with many other opinions of this court cited under Point 4a and in Appendix A, we may point out that likewise there is no absolute right of property, no freedom to use property as one wills, and that the guarantees of the constitution do not withdraw from legislative supervision

the determination of what restrictions and restraints upon property rights must be imposed in the interest of the community.

As applicable to the specific problem before us, we may also point out, (1) that it may be necessary for the courts to define, according to their best judgment, the public policy of the State in the absence of a specific legislative declaration, but (2) that when the Legislature has defined, as here, a public policy of rate regulation and has required the administrative commission created to carry out this policy, to consider *all* "elements of value," no proper appeal can be made to any court to ignore this legislative policy, to disregard the legislative directions for its enforcement, and to direct an administrative commission to put into effect an entirely *different* policy, by considering only *one* "element of value," which may be fairly described as the monopoly element of value. We quote further from the opinion in the case last cited as follows:

> "Nor was the holding of the court final upon the point of public policy, so far as the power of the legislature is concerned. The legislature, provided it acts within its constitutional authority, is the arbiter of the public policy of the state. While the court, unaided by legislative declaration, and applying the principles of the common law, may uphold or condemn contracts in the light of what is conceived to be public policy, its determination as a rule for future action must yield to the legislative will when expressed in accordance with the organic law" (p. 565).

In this case the court also laid down the respective fields of legislative and judicial power in the following pertinent language:

> "The principle involved in these decisions is that where the legislative action is arbitrary and has no reasonable relation to a purpose which it is competent for government to effect, the legislature transcends the limits of its power in interfering with liberty of contract; but where there is reasonable relation to an object within the governmental authority, the exercise

of the legislative discretion is not subject to judicial review. The scope of judicial inquiry in deciding the question of *power* is not to be confused with the scope of legislative considerations in dealing with the matter of *policy*. Whether the enactment is *wise or unwise*, whether it is based on *sound economic theory*, whether it is the *best* means to achieve the desired result, whether, in short, the legislative discretion within its prescribed limits should be exercised *in a particular manner*, are matters for the judgment of the legislature, and the earnest conflict of serious opinion does not suffice to bring them within the range of judicial cognizance" (p. 569).

A Comment Upon McArdle v. Indianapolis Water Co.

So much emphasis has been laid (unwarrantably) by counsel for the carriers upon the opinion of this court in *McArdle v. Indianapolis Water Co.*, 272 U. S. 400, that a brief comment upon this opinion seems desirable—although probably unnecessary.[1] It is claimed that a valuation formula has been announced in the McArdle case in such language as the following:

> "* * * if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property."

Such a flat statement, as that just quoted, can be nothing more than the reason for the decision of this *one* case. The court has been committed by a long line of decisions to the propositions: (1) that "cost" is *not* the measure of "value"; (2) that "reproduction cost" is not the measure

[1] "The proposition that effective and predominating consideration must be given to present costs is definitely established by the Supreme Court in the case of Bluefield Waterworks v. West Virginia Public Service Commission, 262 U. S. 679, and again in the decision in McArdle v. Indianapolis Water Company, 272 U. S. 400." Reply Brief for Carriers in District Court, p. 42.

of "value for rate-making purposes"; (3) that no "formula" can be stated for fiding a "value". All of these propositions have been affirmed in recent opinions of the court, which were written by the writer of the opinion in the McArdle case. (*Bluefield Water Works etc. Co.* v. *Public Service Com.*, 262 U. S. 679; *Standard Oil Co.* v. *Southern Pacific Co.*, 268 U. S. 146.) Therefore, such a statement as the one quoted cannot be regarded as the expression of a formula of valuation—for at least three reasons:

1. The announcement of such a formula would reverse the established doctrine that there is no formula. (See cases cited under Point 6.)

2. The announcement of such a formula would be a legislative act, providing a "rule for the future" instead of a judicial rule for the decision of a specific case.

> "A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist * * *. Legislation, on the other hand, looks to the future and changes existing conditions by making a new rule. * * * The establishment of a rate is the making of a rule for the future, and therefore is an act legislative not judicial in kind. * * *" *Prentis* v. *Atlantic Coast Line Co.*, 211 U. S. 210, 226.

3. The announcement of such a formula, if intended to apply to other valuations—and particularly if intended to apply to the valuation of railroad property under the Interstate Commerce Act—would have amounted to a declaratory judgment upon the well-known-to-be-pending problem of railroad valuation and rate regulation, which, for many obvious reasons, would have been so grossly improper that the assumption that such a judgment was intended cannot be entertained. (*Cohens* v. *Virginia*, 6 Wheat. 264, 399.)

For these reasons it is inconceivable that the majority opinion in the *McArdle* case will carry any weight of au-

thority into the discussion of the present case. We assume that the court will not permit the language of that opinion to be so construed and applied as to support the arguments of counsel for the carriers in this case. Therefore, we refrain from any further reply to the contention that in the *McArdle* case the court approved of a formula for the valuation of railroad property, based upon concepts of "value" and "property" whose falsity has been demonstrated long ago in the writings of authoritative economists and jurists, and in the opinions of this court.

Point 19.

It is respectfully submitted that in the present case the carriers have not been deprived of any property right to charge a fair price for services rendered, or of any property value based on such a property right; that the rates, the earning power and the resultant value of the property of the carriers were established by the Interstate Commerce Commission, in a conservative exercise of the legislative power of rate regulation, well within the limits of the range of legislative discretion; all in conformity with the laws and the Constitution of the United States.

This brief might be extended to great length in order to present to the court an adequate review of the economic factors justifying and supporting the principles of rate regulation and value regulation which have been applied by the Interstate Commerce Commission in the valuation of railroad property. The Commission has dealt with one of the greatest economic problems ever presented to government officials, under a legislative command to find a "just and reasonable" solution. An eminent economist has well written:

"It is not too much to say that the future of democracy will depend on its success in dealing with the problems of public ownership and regulation."

Taussig, Principles of Economics (1911), 411.

But no consideration of this problem, however exhaustive, could serve to endow this court either with the intimate knowledge and experience, or with the duties, powers and responsibilities, of the Commission to whom the regulation of interstate commerce has been entrusted. In the separation of functions of government there is a wiser purpose than merely to provide a system of "checks and balances". In this separation there is recognition of the inherent limitations upon human capacity for experience and upon human ability to "get understanding".

To the earnest student of judicial problems there is often a grave error in a slight deviation from established doctrine, which the impatient executive, or the thwarted legislator, may regard as a useful short-cut to a desirable accomplishment. Only judicial experience and responsibility will give a full understanding of why the courts lean so heavily upon *stare decisis* and hold that "their motto should be *obsta principiis.*" (*Boyd* v. *United States*, 116 U. S. 616, 635.)

Likewise, to the painstaking student of legislative problems, there is often a grave need for the exercise of political power so as to maintain, or to re-establish, a just balance of economic power, which to the judicial interpreter may seem unnecessary and unwise. Only legislative experience and responsibility will give a full understanding of the pressures of public opinion and the probable values of legislative measures which develop out of a continuing conflict between general and particular interests.

The same theory of government, under which legislative power is asked to respect the conscientious exercise of judicial power within its appropriate sphere of action, requires that judicial power exhibit a reciprocal respect for the con-

scientious exercise of legislative power. One respect will hardly thrive in the absence of the other. "The earnest conflict of serious opinion" concerning what are "reasonable rates" does not suffice to bring "within the range of judicial cognizance" the charge that the Interstate Commerce Commission has violated the constitution.

That there is such a conflict of opinion has been long since demonstrated—not merely in the discussions in legal and economic reviews and in the rulings of the commissions which "working at first hand with the practical problems of valuation generally lean more and more decidedly toward fixing value—socalled—of public utilities on prudent investment largely, and in not a few cases wholly."[1] The most complete demonstration that there is an "earnest conflict of serious opinion" is found in a review of the opinions of Supreme Court during the last fifty years, exhibiting frequently an apparent "contrariety of decision" that "cannot be reconciled" (to use the language of Mr. Justice McKenna[2]).

We might begin such a review with the holding that "the limit upon rates fixed by the Legislature binds the courts" and that "the Legislature, not the courts, must be appealed to for the change." *Peik* v. *C. & N. W. Ry.*, 94 U. S. 164, 178 (1877). Next comes the warning that the power to regulate rates "is not a power to destroy, and limitation is not the equivalent of confiscation." (*Railroad Commission Cases*, 116 U. S. 307, 331 (1886)). Then appears the holding that the reasonableness of rates "is eminently a question for judicial investigation." (*C. M. & St. P. Ry. Co.* v. *Minnesota*, 134 U. S. 418, 458 (1890)). But during all the years since the court decided the first conflict of opinion (as to the propriety and scope of a judicial review of legislative action) there has been no

[1] 19 Michigan Law Review 849, 852 (1921)

[2] Georgia Ry. & Power Co. v. R. R. Com. of Georgia, 262 U. S. 625

fixation of the standards of review. Almost every discussion of "value" as a rate base has been interwoven with discussions of the protection of "investment" and the proper return upon "investment."

> "A public utility is entitled to such rates as will permit it to earn a return on the *value* of the property which it employs for the convenience of the public equal to that being made at the same time and in the same general part of the country on *investments* in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."
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> *Bluefield Water Works and Improvement Co.* v. *Public Service Commission*, 262 U. S. 679.

> "By *investment* in a business dedicated to the public service, the owner must recognize that as compared with *investment* in a private business, he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit."
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> *Dayton-Goose Creek Railroad Co.* v. *United States*, 263 U. S. 456, 481.

Indeed four years after the "fair value" rule of *Smyth* v. *Ames*, *supra* (1898) was announced this rule was defined as "a general proposition that the railroads are entitled to a fair return upon the *capital invested*." (*Minnesota & St. Louis Ry. Co.* v. *Minneapolis*, *supra*, (1902).

From the time of *Smyth* v. *Ames*, *supra*, to date, there is continuing evidence of an "earnest conflict of serious opinion" within the court concerning what principles of law and political economy, and what bases for a sound public policy, can be utilized to measure the reasonableness of public utility rates. Over and over again it has been written that private property must be given a "fair value", and that valuation is "not a matter of formulas, but there must be a reasonable judgment having its basis in a proper

consideration of all relevant facts." And the only possible reconcilation of the many apparently conflicting decisions of the court is that in each case the court has decided whether rates complained of were, or were not, the product of a "reasonable judgment" exercised after "proper consideration".

Accepting the foregoing as the *sole* standard for judicial review, which has ever been laid down and maintained by the court, we must submit that counsel for the carriers are asking the court to set aside this standard, to reverse every opinion handed down since the opinion in *Smyth* v. *Ames*, and to establish a "formula" for rate-making which will prevent the exercise of a "reasonable judgment," and which thereby will destroy the substance of legislative power in rate regulation. Because—(1) There is now presented to the court the report of the Interstate Commerce Commission, to whose findings "this court has ascribed • • • the strength due to the judgments of a tribunal appointed by law and informed by experience." (2) This tribunal has given most careful, painstaking consideration, not only to all the "relevant facts" which are detailed in the record, but also to the infinite variety of facts accumulated by the commission in the performance of its duties, which constitute its "experience" and which are incapable of translation into documentary form, but which form the background clearly visible behind its stated opinions. (3) This tribunal has arrived at a "reasonable judgment"—that is, an opinion which the Supreme Court itself obviously *might* have reached at any time, in the settlement of the "earnest conflict of serious opinion" which this court has been describing in its opinions during the last fifty years.

If any *real* exercise of "judgment" and "discretion" is to be permitted, not even a profound disagreement upon matters of conflicting opinion—upon debatable issues of

public policy—will justify the substitution of a judicial *theory* for a legislative *theory*. The theoretical or experimental field of political action, wherein issues of public policy are debated and decided, is distinctly not the province of the judiciary and is preeminently the legislative domain. There is, of course, the limitation that the legislative act must be "consistent with the fundamental law" and *not* "in opposition to the theory of our institutions." (*Smyth* v. *Ames, supra*, p. 528.) But when the attack upon the legislative act is the generalized complaint of a lack of "due process", the court is asked to hold that there has been an "arbitrary exercise of the powers of government, unrestrained by the established principles of private rights and distributive justice". (*Bank of Columbia* v. *Okely, supra*, p. 244.)

How can such a ruling be sought in this case, in view of the conflict of opinion upon the present subject matter, which has been reviewed, and has remained undetermined, in the opinions of this court during the last fifty years? How can a ruling be sought to the effect that the Interstate Commerce Commission has not exercised a "reasonable judgment", in utilizing standards of "reasonableness" and theories of "justice" which have been repeatedly approved in the majority and minority opinions of this court? Can these opinions be reconciled except upon the ground that a "reasonable judgment" depends upon the possession of adequate information and its impartial consideration by competent persons, actuated by a conscientious intention to compromise fairly the conflicting economic interests revealed? The court is, in fact, asked to hold that the Commission is either incompetent or unwilling to exercise a "reasonable judgment", because it admittedly possessed and carefully considered adequate information upon which to base its judgment.

It seems difficult logically to ask this court to hold that the Commission's judgment concerning a fair and practical

basis for rate-regulation is unreasonable, when one reviews the reasons (quite similar to those which moved the Commission) which were held (by the Supreme Court) to justify Congress—"in basing 'invested capital' upon actual costs to the exclusion of higher estimated values," in an income tax law. The following quotation from that opinion of the court seems most pertinent to the present issue:

> "There is a logical incongruity in entering upon the books of a corporation as the capital value of property acquired for permanent employment in its business and still retained for that purpose, a sum corresponding not to its cost, but to what probably might be realized by sale in the market. *It is not merely that the market value has not been realized or tested by sale made, but that sale cannot be made without abandoning the very purpose for which the property is held, involving a withdrawal from business so far as that particular property is concerned.* Whether in a given case property should be carried in the capital account at market value rather than at cost may be a matter of judgment, depending upon special circumstances and the local law. But certainly Congress, in seeking a general rule, *reasonably might adopt the cost basis, resting upon experience rather than anticipation.*"
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> *LaBelle Iron Works* v. *United States*, 256 U. S. 377, 393.

There are distinctions which may be drawn between a taxation case and a rate-regulation case, but it is submitted that the reasoning of the court in the foregoing opinion gives powerful support to the reasoning of the Interstate Commerce Commission in the present case. If it is *reasonable* to tax corporations on profits computed on the basis of "invested capital", it is difficult to see why it is *unreasonable* to compute, on the same basis, the amount of the fair profit which should be allowed to public service corporations when their rates are regulated. The Supreme Court and the Interstate Commerce Commission apparently agree that there is a "logical incongruity in entering upon the books of a corporation, as the capital value of

property", a market value that has not been realized and which cannot be realized without abandoning the very purpose for which the property is held. This "logical incongruity" is strongly emphasized in the case of a public service corporation which has no legal right to sell its property and abandon "the very purpose for which the property is held."

In the present case counsel for the carriers have asked the court to hold that the Interstate Commerce Commission has violated the Constitution, has defied the law of the land, has challenged the courts and "should receive a rebuke" from the judiciary,[1] because, forsooth, the Interstate Commerce Commission has declined to accept a "logical incongruity" as a rule of reason. In final answer to these turgid claims let it be pointed out that--

1—Congress has enacted a law in order to exercise a power "to regulate commerce" which is specifically conferred in the Constitution.

2—Congress has confided the administration of the public policy which it has defined to a permanent commission of recognized ability, long experience and tested responsibility.

3—This administrative commission has been dealing with the specific problem of valuation for rate-making purposes for over fifteen years, taking testimony and hearing arguments in over a thousand valuation proceedings, covering approximately 250,000 miles of road, owned by corporations which have outstanding (in round figures) over $9,000,000,000 capital stock and about $12,500,000,000 funded debt. These corporations received, in the year 1926, $6,382,939,546 as operating revenues and obtained a net railway operating income of $1,229,000,465. (41st Annual Report Interstate Commerce Commission, pages 108-109.)

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[1]Reply Brief for Carriers in the District Court, p. 51.

4—This administrative commission, to whom had been long confided the stupendous problems of rate-regulation (including value regulation) and service regulation, was charged, under the Transportation Act of 1920, with the additional grave responsibility of administering the law so as "to build up a system of railways prepared to handle promptly all the interstate traffic of the country" and "to foster, protect and control the commerce with appropriate regard to the welfare of those who are immediately concerned, as well as the public at large, and to promote its growth and insure its safety". (*Dayton Goose-Creek case, supra*, p. 477.)

5—This administrative commission has taken up, one by one during a period of fifteen years, all the debatable issues which have arisen in connection with value regulation (while at the same time it has been continually deciding the innumerable issues involved in detailed rate regulation); and this Commission has heard all the evidence produced by all the interested parties and all the arguments presented in behalf of all the public and private interests involved.

6—This administrative commission has reached conclusions which have been expressed in many exhaustive and detailed reports; and, through this long and careful consideration, has arrived at a judgment which is expressed in the report made and order entered in the present proceeding.

It is submitted that the validity of this "reasonable judgment" of the Interstate Commerce Commission—produced under the authority conferred and after the consideration which has been given to the facts and to the legal and economic issues involved—a judgment supported by the consensus of authoritative legal and economic opinion which has been reviewed in this brief—cannot be subjected to judicial revision, unless, contrary to established law, the

court sits "as a board of revision" to substitute its judgment for that of the legislature and the commission.

The contentions of counsel for the carriers in this case have been answered many times by the Supreme Court in such language as the following:

> "As remarked by Chief Justice Taney in *Luther* v. *Borden*: 'The high power has been conferred on this court of passing judgment upon the acts of the state sovereignties, and of the legislative and executive branches of the federal government, and of determining whether they are beyond the limits of power marked out for them respectively by the Constitution of the United States. This tribunal, therefore, should be the last to overstep the boundaries which limit its own jurisdiction. And while it should always be ready to meet any question confided to it by the Constitution, it is equally its duty not to pass beyond its appropriate sphere of action, and to take care not to involve itself in discussions which properly belong to other forums.'"
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> *Taylor* v. *Beckham*, 178 U. S. 548, 580.

The Administrative Powers of the Commission.

There is a fatal weakness in the "last-ditch" argument that Congress has not authorized the Commission to set up and apply the standards of rate regulation and value regulation expressed in its report.[1] The duties of the Commission were defined with notable clarity and vision in the response of the present Chief Justice to the presentation of resolutions concerning the services of the late Chief Justice White, on January 16, 1922—printed in Appendix VIII in Volume 259 of the Supreme Court Reports:

> "The capital importance which our railroad system has come to have in the welfare of this country made

[1] "If the economics of the law of the land on this subject of valuation are as unsound and dangerous to public welfare as the Commission and its counsel would have the court believe, the remedy is obviously legislative not judicial." Reply Brief for Carriers in District Court, p. 51.

the judicial construction of the Interstate Commerce Act of critical moment. It is not too much to say that Chief Justice White, in construing the measure and its great amendments, has had more to do with placing this vital part of our practical government on a useful basis than any other judge. His opinions in the case of the *Texas & Pacific Railway Co.* v. *The Abilene Cotton Oil Co.*, and the cases which followed it, are models of clear and satisfactory reasoning, which gave to the people, to state legislatures, to Congress, and the courts a much-needed knowledge of the practical functions the Commerce Commission was to discharge, and of how they were to be reconciled to existing governmental machinery for the vindication of the rights of the public in respect of national transportation. They are a conspicuous instance of his unusual and remarkable power and facility in statesmanlike interpretation of statute law.

"The Interstate Commerce Commission was authorized to exercise powers the conferring of which by Congress would have been, perhaps, thought in the earlier years of the Republic to violate the rule that no legislative power can be delegated. But the inevitable progress and exigencies of government and the utter inability of Congress to give the time and attention indispensable to the exercise of these powers in detail forced the modification of the rule. Similar necessity caused Congress to create other bodies with analogous relations to the existing legislative, executive, and judicial machinery of the Federal government, and these in due course came under the examination of this court. Here was a new field of administrative law which needed a knowledge of government and an experienced understanding of our institutions safely to define and declare. The pioneer work of Chief Justice White in this field entitles him to the gratitude of his countrymen."

"The inevitable progress and exigencies of government and the utter inability of Congress to give the time and attention indispensable to the exercise of these powers in detail"—has compelled delegation to the Interstate Commerce Commission of approximately the full legislative discretion in the exercise of the legislative power of rate-mak-

ing. The reserved power of Congress, to change the law and to provide more or less specific directions for the administration of the delegated rate-making power, only emphasizes the breadth of the power expressly and designedly conferred upon the Commission in the present Interstate Commerce Act.

The Commission has exercised this power with painstaking care, after exhaustive and impartial consideration of all the relevant facts and all the interests involved. In its formulation of a "reasonable judgment" regarding the value of property for rate-making purposes, it is the legislative power of rate regulation that has been exercised—well within the range of legislative discretion, in conformity with the laws and the Constitution of the United States.

It is respectfully submitted that the decree of the statutory three judge court, sustaining the order of the Interstate Commerce Commission, should be affirmed.

Respectfully submitted,

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